

AN EVALUATION OF
CIA WORK ON SOVIET ECONOMIC
CAPABILITIES, PROBLEMS, AND PROSPECTS

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TABLE OF CONTENTS

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	<u>Page</u>
OVERVIEW	1
CIA's View of Soviet Economy	1
The Panel's Overall Assessment	3
FOREWORD	8
Background	8
Objective	8
Conduct of the Review	8
The Report	9
Standard for Evaluation	10
SUMMARY EVALUATION	11
Key Observations	11
1. General Assessment	11
2. Methodology	14
3. System Adjustment Capabilities	20
4. Context	23
5. Indication of Reliability	25
6. Tone	25
7. Underdeveloped Areas	27
Appendix A. Panel Members	34
Appendix B. Statement of Mission and Objectives	35
Appendix C. Subtopics and Subcommittees	39
Appendix D. Tonality in CIA Reporting	40
Appendix E. A Note on the Accuracy of GNP Data Needed for Decision-Making	49
SUBTOPIC EVALUATIONS AND RECOMMENDATIONS	53
I. National Accounting	54
1. Introduction	54
2. Methodology	55
3. Empirical Estimation Problems	58
4. Communication	62
5. Conclusion	63
II. Growth Problems, Projections, Organizational and Policy Change	64
III. Energy	70
1. Introduction	70
2. Methodology and Findings	70
3. Recommendations	73

CONFIDENTIAL

IV.	Agriculture and Food	76
	1. Methodology	77
	2. Findings, Interpretations and Conclusions	79
	3. Clarity of Presenting Findings	87
V.	Foreign Economic Relations	88
	1. Introduction	88
	2. The Global Context of Soviet Trade & Finance	88
	3. The Conceptual Framework of Analysis	89
	4. Specific Methodologies	90
	5. Analysis of Soviet Behavior and Foreign Trade Forecasts	93
	6. Intelligence Crucial for U.S. Policy on East-West Economic Relations, 1980-83	94
VI.	The Soviet Burden of Empire	99
	1. Introduction	99
	2. Major Conclusions	100
VII.	Quality of Life, Morale, and The Second Economy	105
	1. Introduction	105
	2. Methodology	106
	3. Interpretations	109
	4. Communication of Results	110
	5. The Second Economy	114
VIII.	The Effects of Slow Growth on System Stress, and National Security	116
	1. System Stress	116
	2. National Security Impact of Slow Growth	119
IX.	Soviet Leadership Perceptions	123
	1. Introduction	123
	2. Findings, Interpretation, Conclusions	124
	3. Methodology, Sources of Data, and Date Base	127

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OVERVIEW

The Panel, established by the President's Foreign Intelligence Advisory Board, was charged with the task of assessing CIA's work on Soviet economic capabilities, problems, and prospects. This is an overview of the Panel's findings.

CIA's View of Soviet Economy

The Panel takes the December 1982 statement of Henry Rowen before the Joint Economic Committee to be the most authoritative recent statement of the CIA's assessment of the Soviet economy. The following is the Panel's summary of the main points of that assessment.

1. Between 1950 and 1981 Soviet GNP grew at an average rate of 4.6 percent per year. The central fact, however, is that the Soviet growth rate has been declining, moderately before 1978, and sharply thereafter. In the 1950's it was growing at 6 percent per year; by 1979-81 it was down to less than 2 percent per year.

2. The forecast is that the economy will continue to grow in the foreseeable future but at a slow rate, between 1 and 2 percent per year.

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1

3. The economy suffers from a great many weaknesses, such as the depletion of its best natural resources, difficulties in improving productivity and promoting technological progress, and an agricultural sector that is both costly and inefficient. But it also has a number of strengths, such as its exceptional endowment of natural resources, its substantial capital stock, and large and well-educated labor force. Furthermore, while its centralized political control over the economy and the population may be an economic millstone, it does enable the leadership to mobilize resources to achieve priority objectives.

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4. Considering its strengths and its weaknesses, the economy can be regarded as performing poorly in recent years. This does not mean, however, that it is losing its viability. There is not even a remote possibility that the economy will collapse.

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5. The major consequence of the slow growth rate is that it is harder for the leadership to maintain all its past commitments: to military and foreign policy goals, to the raising of living standards and the quality of life, to the promotion of economic growth by high investment rates, and to the preservation of traditional methods of centralized economic planning and management. Some of those commitments will have

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to be scaled down, but the decisions will be based primarily on the leadership's own priorities and political judgments.

6. Though highly self-sufficient, the USSR is not autarkic. Imports of Western capital, technology and grain are important for the maintenance of economic growth, but due to its basic self-sufficiency, Soviet vulnerability to economic leverage is limited.

The Panel's Overall Assessment

The Panel, after studying CIA reports written over the past five years and conferring with CIA analysts, is in general agreement with the assessment just presented, and offers the following observations:

1. CIA's quantitative estimates of past Soviet output levels and rates of growth are the best available. Because of the paucity of published data, analysts of the Soviet economy must use methods which are sometimes different from those used by analysts of Western economies. The methods used by the CIA have stood the test of the market-place; they are those preferred by the great majority of specialists on the Soviet economy. Analysts using other methods have produced estimates some of which are higher than those of the CIA and some,

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lower. In the Panel's judgment none of the alternative methods have been proven to be superior to those of the CIA.

2. Because of data limitations, the best estimates of Soviet growth must be expected to have a greater margin of error than similar estimates for developed market economies. While there is no way of precisely stating the margin of error in the CIA estimates, the Panel does feel that the CIA should make more of an effort to establish an upper and lower bound for the possible error. However, it is the Panel's best judgment that the error is not likely to be so large that its elimination would change one's assessment of the strengths and weaknesses of the Soviet economy. Though one should not place high confidence in the precise measure of past growth rates, one can have a high degree of confidence in the broad facts: (a) the Soviet growth rate has been declining; (b) its present level is sufficiently low as to place national policy under considerable strain, without being a harbinger of collapse. It is these facts that are the most important for US policymakers to know.

3. While CIA's measurements of Soviet economic performance have been quite strong, its interpretations of these measurements have at times been less so. The most difficult task of intelligence analysis is to assess the significance of the low Soviet growth rates for Soviet

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policymaking and for the condition of Soviet society. Unlike the measurement of growth rates, there does not exist a body of formal social theory and method upon which the CIA can draw for such an assessment. At its best, the assessment should be based on a sophisticated understanding of political and social processes, on a thorough knowledge of Soviet/Russian history and culture, and on the fullest available evidence on current events and conditions in the USSR. The Panel finds that the Agency's capability can be improved in a number of these respects and has made several recommendations toward that end.

4. Furthermore, while the Panel endorses the Rowen 1982 assessment summarized above, it finds that past CIA reports and testimony have frequently overemphasized the weaknesses, problems, and vulnerabilities of the Soviet economy, and may therefore have contributed to an excessively negative view of Soviet economic conditions and prospects held by some policymakers. This may have been due in part to the CIA view that the policymakers were interested primarily in Soviet weaknesses. The Panel finds, however, that there were other reasons, among them (a) a tendency to underestimate the capability of the Soviet leadership to respond effectively to growing difficulties (e.g. in oil production, foreign trade); (b) use of colorful and emotive language instead of dispassionate and neutral prose in communicating research findings; and (c) an unarticulated assumption that there is a

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1
simple causal link between poor economic performance and such social ills as low morale, social unrest, lawlessness, and so forth. The Panel offers a number of recommendations to improve Agency analysis and reporting practice in such respects.

5. Most (although not all) of the recommendations for improvement in CIA work on the Soviet economy discussed in this Report relate to CIA's interpretation and communication of the meaning of its estimates of Soviet economic performance, rather than to the estimates themselves. Therefore, the weaknesses referred to do not essentially diminish the confidence the Panel has in CIA's quantitative measurements of Soviet output and growth.

6. The Panel has the impression that policymakers' concerns about analyses of the USSR have at times focused excessively on the accuracy of CIA and alternative estimates of Soviet GNP and its growth. While useful in assessing Soviet economic strength and political viability, such aggregate indices can provide only limited insights--particularly for closed societies like the Soviet Union. Indeed, policy issues typically involve such difficult questions as the ability of the Soviets to sustain or increase their military capability and the degree of stress on the Soviet system, issues so complex and requiring consideration of so many additional factors that final assessments would not likely be changed by

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the difference between the actual and the estimated GNP levels and growth rates. In the assessment, for example, of military capability such factors as international tensions, specific industrial capabilities, political conflicts, bureaucratic inefficiencies, and ethnic strains may dominate the slowdown in GNP growth. And in the assessment of system stress, such factors as party and policy controls, interests vested in the regime, traditional attitudes toward authority, and again ethnic strains are involved.

7. CIA's growth forecast for the 1980s (1-2 percent per year) is derived by means of standard methods and the Panel finds the forecast reasonable. However, the uncertainty is large in any medium to long-term forecast, including one of the Soviet economy. The Panel believes the Agency should accompany its forecasts with clearer warnings of the limitations in confidence with which they should be viewed.

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FOREWORDBackground

The President's Foreign Intelligence Advisory Board (PFIAB), in its first semiannual report to the President dated 2 August, 1982, noted that the Soviet Union will be facing serious economic problems during the remainder of this decade, and that accurate assessments of Soviet economic prospects may be critical to future foreign policy decisions. The PFIAB concluded that an independent review of the intelligence community estimates in this regard would be prudent. On the President's behalf, the National Security Council directed the Department of Commerce to organize a Panel of highly qualified experts, from outside the intelligence community, to undertake such a review (members of the Panel are listed in Appendix A). Responsibility for the management of this effort, as requested by the PFIAB, was given to the Under Secretary for International Trade, Lionel H. Olmer.

Objective

The basic objectives established for the Panel were as follows (the full charge to the Panel is reproduced in Appendix B):

1. to evaluate the methods and assumptions used by the intelligence community in estimating Soviet economic performance;
2. to assess the validity of intelligence community findings, interpretations, and conclusions; and
3. to examine the clarity with which these findings, interpretations, and conclusions are presented to policymakers.

The Panel was not to review the measurement of Soviet military expenditures (this being the subject of a separate study under the auspices of the Director of the Central Intelligence Agency), nor was it to analyze new foreign policy options or examine past foreign policy decisions. The Panel was not expected to undertake new research and, therefore, was not expected to provide alternative estimates of Soviet economic performance.

Conduct of the Review

The Panel divided its work into nine subtopic areas (not all of equal importance), each to be examined by a subcommittee of the Panel (see Appendix C).

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The Panel met six times in plenary sessions in addition to meetings of its subcommittees. The focus of its investigation was almost exclusively on the work of the CIA, which dominates the study of the Soviet economy in the intelligence community. At the beginning of its review, the Panel sent an extensive list of questions to the CIA. The Agency, rather than responding at length to these questions, preferred to have Panel members read relevant CIA reports and confer with CIA analysts.

The Panel read more than 100 classified and unclassified reports, conferred with CIA analysts, met with representatives of several key users of intelligence on the Soviet economy (the Department of State, Department of Defense, and the NSC), and read a preliminary report by a Department of Commerce team (Michael Boretsky, et al.) on a methodological question concerning CIA's measurement of Soviet economic growth. The Panel, however, does not know which of the reports it reviewed were widely read and discussed by policymakers; and it has not had access to reports classified above the level of "Secret," or to informal memos, or oral briefings of policymakers. The Panel, therefore, well realizes that there is still much it could learn about the work of the CIA on the Soviet economy, and it presents its evaluations with that consideration in mind.

Furthermore, since the Panel did not survey the user community in a systematic way, it will not comment on whether the CIA adequately and in a timely manner addressed the expressed concerns of policymakers.

The Panel wishes to acknowledge the excellent cooperation of the CIA in providing documents and making the time of CIA staff available to Panel members for discussions. This cooperation was vital to the success of the Panel's review.

The Report

The Report is divided into two parts. The first is a Summary Evaluation, containing the Panel's key observations and recommendations. The second contains more detailed Subtopic Evaluations and Recommendations.

The Summary Evaluation part of the Report represents a consensus agreed to by all members of the Panel.(1)

The Subtopic Evaluations and Recommendations sections were drafted by individual subcommittees. The main conclusions are those of the whole Panel, and are reflected in the Summary Evaluation. However, though the subcommittee findings were

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discussed by the full Panel, the Panel did not attempt to agree on the complete text of each subcommittee report.

The Panel recognizes that CIA has operated under a resource constraint and has had to make choices among the topics it might want to pursue. Consequently, the Panel realizes that if its recommendations were to be implemented, CIA would require additional resources.

Standard for Evaluation

To guide its evaluation, the Panel adopted the following performance standard for intelligence community work on the Soviet economy:

As a nation, we require continuous assessment of the Soviet's economic capacity, now and in the future,

- a) to establish, sustain, and use military power;
- b) to project political and economic power in the world;
- c) to maintain their socio-political system.

The intelligence community's assessment of Soviet economic capacity should cover certain key aspects of Soviet economic performance. First, we need an estimation of current and past production levels and trends (the national accounts), and of the resources used in production (labor, capital, land, and materials). This estimation also requires the evaluation of efficiency and of the role played by systemic elements in the determination of efficiency. Second, there must be an estimation of the potential for the Soviet economy to grow by increasing inputs, and by raising productivity. And third, there must be an assessment of the system's ability to adjust in response to accumulating problems, external shocks and shifts in central priorities.

In the various aspects of its assessment of the Soviet economy, the intelligence community should be expected to employ the best methods available. And while innovation in methodology might usually be left to the academic community, there are situations where intelligence needs require that innovation in methodology be pursued within the intelligence community.

The communication of assessments to policymakers is also an important part of the intelligence process. Assessments should be presented clearly with the range of uncertainty indicated. Assumptions and data sources should be adequately identified. Disagreements arising in the assessment process should be presented, in an appropriate manner, to intelligence users. The language employed should enable users to distinguish judgments from facts in the intelligence product.

Finally, it is necessary that intelligence analysis be objective, free from prejudice and the desire to support particular policies.

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SUMMARY EVALUATIONKey Observations1. General Assessment

The Panel finds the overall work of the CIA on the Soviet economy to be of high quality--quite strong on measurement, somewhat less so on interpretation. The methodologies employed are generally state of the art, equivalent to those used by leading academic specialists working on the Soviet economy. And its research and analysis are as a rule conducted with care and professional competence.

CIA's statistical estimates of past Soviet economic performance are regarded by the Panel to be of high caliber and, though subject to gaps in available Soviet data, and to some problems of estimating methodology (see discussion below), they are at an acceptable level of reliability. It is the Panel's best judgment that the error in CIA estimates of Soviet national income and its rate of growth in the past is unlikely to be so large that its elimination would significantly change the assessment of Soviet economic strengths and weaknesses. It is useful to bear in mind that, while data on the Soviet economy can be expected to be less reliable than data on most developed market economies, no nation produces error-free

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economic data. The key issue is how precise do the estimates have to be to meet the needs of policymakers. With regard to some estimates, for example the number of deployed Soviet missiles, the precision required is quite high. But with regard to most uses of aggregate measures of Soviet economic levels and growth, US policymakers do not need as high a degree of precision.

The Agency's track record on quantitative forecasts of Soviet economic growth has on the whole been good. The forecasts appear to be generally accurate, with a tendency (contrary to the commonly held view) for the Agency to predict higher rates of growth in the 1960s and 1970s than it calculated the Soviets actually achieved.

One notable exception to its generally good forecasting record is CIA's 1977 prediction that Soviet oil output would decrease substantially in the early 1980s--a prediction that has not been borne out. Yet even here, the CIA record has some strong points. For example, the CIA was the first, to our knowledge, to predict that the 1980 target for oil output in the 10th Five Year Plan (1976-1980) would not be achieved.

CIA's ability to recognize its mistakes and to learn from them is considered by the Panel to be an important aspect of

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the Agency's performance. Here, too, CIA's record has been good. Again, using oil as an example, the Panel's general impression is that the CIA has learned from its experience, that its current techniques for forecasting oil output are more sophisticated than they were five years ago, and that the quality of their forecasts is higher as a result.

The CIA has been criticized by some for "sending contradictory signals" when it claimed that the Soviet economy was experiencing increasing difficulties, that the Soviet rate of economic growth was diminishing, but that at the same time Soviet military expenditures continued to rise. The Panel sees no necessary contradiction between these two CIA findings. Given the national security objectives of Soviet leaders and the centralized nature of the Soviet political and economic system, it would not be surprising if the Soviets continued to allocate a large and--if deemed necessary--a moderately increasing share of national resources to the military sector despite the decreasing growth of the economy. Whether, in fact, this was the case in the recent past is a matter of current controversy and reassessment.

The Panel's general assessment of CIA work on measurement of the Soviet economy is quite positive; further aspects of that work worthy of praise could be detailed in this Report. The Panel's main purpose, however, is to contribute to the

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increased quality of the intelligence product by indicating those areas of CIA's work where weaknesses exist and where improvement is called for.

2. Methodology

Most CIA work on the Soviet economy employs state-of-the-art methodology. In some cases, the methodology used by the CIA is below the existing state of the art. And in some cases, primarily those involving political-social issues, the state of the art is poor, not capable of supporting effective analysis. Some examples of each will be presented.

a. State of the Art

Much of the methodology used by the CIA is at the state of the art. This is particularly true in CIA work on Soviet agriculture. In fact, the Panel finds that overall CIA work on Soviet agriculture is of very high quality.

With regard to CIA's estimates of national income and product, the Panel finds that they are calculated with essentially state-of-the-art methodology and with a high level of skill, attention to detail, and sophistication. The Panel knows of no other set of estimates for the Soviet Union that compare with the CIA's in reliability, and in scope, depth, and

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care of construction. At the same time, as the CIA itself indicates at length in its published analyses, there are a number of possible sources of error in its estimating methodology that arise primarily because of the paucity and deficiencies of Soviet data. Two possible areas of systematic bias in its estimates are as follows:

1) The methodology used to estimate indexes of GNP growth employs sub-indexes, often in physical terms, which may not take adequate account of quality improvements over time or introduction of new goods. CIA is fully aware of this problem, but suggests there are countervailing factors in its method of calculation. The Panel recommends that CIA reconsider the possibilities of estimation by other methods including the conventional procedure of deflation of end products, at least as a check on the present method.

2) The Panel notes that CIA comparisons of the size of the US and USSR national income imply that the USSR is in a more favorable position relative to the US than Soviet official calculations show. It can be argued that in this and in other instances the problem lies in CIA's understatement of the general qualitative superiority of American goods and services in the construction of ruble-dollar ratios. The Panel believes that it would be desirable for CIA to provide some explanation for this apparent anomaly in national income comparisons.

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The Panel, however, is impressed with the state-of-the-art international price comparison methodology used by the Agency in its international comparison of consumption in the USSR. This involved extensive, detailed quality comparisons of Soviet and US consumer goods, including the testing by US laboratories of almost 200 individual Soviet consumer goods, purchased for the CIA in the Soviet Union. The Panel feels that when faced with a choice between evidence and impressions, it must go along with evidence. Until sufficient, equally thorough evidence is presented to counter the CIA estimates, CIA's international comparison calculations of consumption in the USSR should be accepted.

CIA is to be commended for acquiring a state-of-the-art econometric macromodelling capability through the development of the econometric model SOVSIM, which it uses in the analysis of medium and long-term growth prospects. An econometric model can play an important role, along with other approaches, in analyzing growth prospects, but it must be used carefully, with due regard to confidence ranges, and its limitations must be recognized. Above all, the consumer of econometric model projections must be made aware that the model does not mechanically crank out projections. Model projections require and are fundamentally based on the assumptions and judgments made by analysts. Furthermore, given the CIA's stress on Soviet oil in the late 1970s, extensive attention in the

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development of SCVSIM was devoted to the energy constraint on economic growth. In future research in this area, greater attention should be devoted to the linkages between foreign trade and domestic production and to the relationships among income, consumption, and labor productivity.

b. Below State of the Art

The dominating characteristic of Soviet growth performance has been the decline in the growth rate, which has become quite significant since the mid-seventies. The principal problem in the analysis of Soviet growth is, therefore, the identification of the sources of the growth decline. The method used by the Agency is what may be called eclectic. It consists of the ad hoc listing of a set of contributing factors: diminishing returns to natural resources, declining allocative efficiency, deteriorating incentives, declining growth of factor inputs, and so forth.

The reports we have read lack a systematic analysis of the process of growth decline. Different sources of the decline in growth are cited in different reports, and their relative importance is not assessed. Some sources of decline cited by CIA appear not to have been carefully thought through, e.g. declining factor productivity is described as a cause of growth decline in a context in which it should be regarded as a

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consequence of that decline. The ad hoc listing of contributory factors, in the absence of an effort at the assessment of relative importance, gives the impression of an overdetermined explanatory system; any subset seems sufficient to explain the decline, without reference to the others.

What is needed is a systematic methodology for the analysis of the decline in growth. The Panel recommends that the Agency explore the use of growth accounting for the systematic quantitative analysis of the sources of the Soviet growth decline. Growth accounting is now an established and tested method, both the contributions and the limitations of which have been fully explored in the economics literature.

Soviet foreign trade decisions and trade dependency have been analyzed by CIA largely in terms of "import requirements" and "export availability." That is an unacceptably simple view of the complicated calculus that underlies Soviet foreign trade decisions. In fact, it is apparent that decisions to export and import in the Soviet Union reflect comparative advantage considerations. The benefits derived from imports are weighed against the alternative costs of producing imported products domestically and against the costs of exports.

By underemphasizing this benefit-cost comparison, the CIA gives insufficient attention to important aspects of Soviet

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behavior--responsiveness to prices, allocation of investment funds to export sectors and import substitution, and reaction to aggregate budget constraints. The Panel recommends that the Agency adopt a methodological approach cognizant of comparative advantage and gains from trade for the analysis and evaluation of Soviet foreign trade.

c. State of the Art Inadequate

CIA work in such areas as quality of life, system stress, and leadership perceptions is hampered by the low level of the methodological state of the art in these areas found generally in the social sciences. A useful methodology linking economic developments to social and political consequences is not available. There is no theoretical framework that coherently relates slow economic growth, worker demoralization, alienation, food riots, strikes, and rising crime rates to political and social stability. The unavailability of such a theoretical methodology leads to CIA analysis in these areas, as is true of such work generally, that is mostly ad hoc and intuitive.

There is a tendency to make assertions about causal links that on the surface seem reasonable, but are not always justified. To take just one example, CIA lays great stress on the need for raising per capita consumption to avoid

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deterioration in work effort and hence in labor productivity. Yet, the process by which the failure to increase per capita consumption affects work effort is neither spelled out nor obvious. To maintain incentives to work would seem to require a supply of consumer goods and services sufficient to satisfy money demand, and a close connection between performance and rewards. The balance between the supply and demand for consumer goods and services could be achieved by raising prices, reducing money incomes, or freezing money balances or destroying their value, as well as by increasing the supply of goods. Given a balance between supply and demand at prevailing prices, it is not entirely obvious why incentives to work are greater if consumption is rising than if it is falling.

The Panel feels that continued and expanded work by CIA analysts in the difficult, soft areas of the impact of economic events on social-political activity and stability is necessary if CIA is to adequately serve the needs of policymakers. The Panel, therefore, recommends that the Agency continue to commit some of its resources to the development of a usable framework for the analysis of economic-social-political linkages.

3. System Adjustment Capabilities

The Panel finds, in CIA's analysis of future Soviet prospects, a frequent failure to take adequate account of the

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Soviet capacity to adjust in response to problems and events. Again, in its work on Soviet agriculture, CIA does well in this regard, but in other areas this is a common weakness.

A noteworthy example is CIA's oil forecasts. One of the main reasons why the original 1977 oil output forecast and the forecast that the Soviet Union would soon become a net oil importer were off the mark was CIA's failure to sufficiently take into account the capacity of Soviet leaders to respond to the problem. The Agency did not adequately consider the possibility that Soviet leaders would rapidly and decisively reallocate investment and labor into the energy sector.

Another example is the Agency's analyses of Soviet foreign trade prospects. The balance-of-payments projections made by the CIA for the 1980s abstracted from Soviet adjustment capacities--both in export generation and import substitution. By ignoring Soviet behavior in their analysis, an image of Soviet "passivity" was communicated. Adequate discussion of Soviet response to shifts in market conditions or Western policies was missing. Importation of Western goods and technology and use of Western credit were too easily regarded as vulnerability, rather than as a pattern of Soviet behavior, under the given leadership preferences and the existing external conditions.

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A further aspect of the system adjustment issue concerns the tendency of CIA analysts, when they do address possible Soviet responses to economic problems, to treat each possible policy separately, rather than assessing the potential effect of a combination of policies. It is rare, in any economy, for an individual policy or program by itself to have a dramatic effect on the economy. But the sum of individual small effects, including a possible synergistic element, may add up to something more significant.

In addition, the CIA usually puts too much emphasis in its projections on the need for Soviet leaders to solve each of their economic problems rather than to manage them. In all economic systems, many problems are hardly ever solved; they are generally simply managed.

The Panel recommends that CIA pay more attention to the possible range of system responses to economic problems and events, and to the development of improved methods of evaluating the possible effects of such responses. In addition, the policy of integrating political analysts into the studies of Soviet economic prospects, pursued by CIA since the formation of SOVA, should be continued and strengthened.

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4. Context

The Panel finds that CIA often does not put its analyses into the proper comparative, historical, and systemic contexts, necessary for policymakers to fully comprehend the implications of CIA analyses. To accurately assess the Soviet situation, policymakers need information about how Soviet economic performance and problems compare with those of other nations. CIA frequently provides such comparisons when presenting economic data on past Soviet performance, but it rarely does so when discussing the current situation or future prospects.

Policymakers also need to be informed whether current Soviet problems are historically unique or have occurred in past Soviet or Russian history, and if such problems have occurred previously, what was the situation and outcome.

Finally, and perhaps most importantly, Soviet problems and prospects need to be put into the context of the Soviet system and Soviet society. There needs to be a consistent balance in CIA reports that takes into account both Soviet strengths and weaknesses. CIA reports appear preoccupied with problems, and in some cases the summary key judgments highlight pathologies even more than the reports themselves. People who are familiar with Soviet society understand that there is another side, that there are strengths as well as weaknesses. But not all

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policymakers, who rely on the Agency reports, have this background. When they read about declining rates of economic growth and the problems of malaise, nationality tensions, food shortages, falling health standards, and the like, they are not in a position to put these matters into an appropriate perspective. If they were reading about such US problems as unemployment, racial tensions, poverty, urban decay, declining educational attainment, they would understand the broader social and historical context sufficiently to place such dark facts about the contemporary US scene in a proper perspective. Lacking a knowledge of the corresponding Soviet context, they are likely to emerge with an exaggerated impression of the weaknesses of Soviet society relative to its strengths.

The Panel recommends that the Agency strive for more consistent balance in its reports, taking into account Soviet strengths and weaknesses, and that it put more of its analyses in the relevant comparative and historical contexts. In order to do this effectively, the Agency will need to recruit or train, preferably at a major university center, more analysts working on the Soviet economy who are well grounded in Russian area studies. Furthermore, it should make it attractive to those with broad backgrounds and extensive experience to remain as analysts rather than moving into managerial positions as the only form of upward mobility.

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5. Indication of Reliability

The Panel believes that the Agency generally conveys an impression of more confidence in the reliability of its findings than is warranted. However, the Panel realizes that this is a complicated issue. Users want point estimates in quantitative analyses; and the danger in providing ranges of estimates or alternative scenarios is that it forces users to make a judgment that the CIA analyst is generally better qualified to make. Furthermore, the Panel is aware of past, unsuccessful Agency attempts to employ "language codes" to express predictive confidence. Nevertheless, the Panel feels this is an important issue and recommends that the Agency strive to increase its communication of the degree of confidence to be placed on individual reports. It should also indicate, where appropriate, the existence of disagreement among analysts on its findings. And it should pay particular attention to communicating the degree of confidence in those findings involving surprises as opposed to findings which confirm previous findings.

6. Tone

CIA reports are usually well written. Material that is potentially quite dull is presented in a lively, interesting manner that succeeds in catching the reader's attention. The

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trouble, however, is that the liveliness of the prose is due to a certain breeziness of style that produces impressions upon the reader that are not always warranted by the underlying analysis. Certain CIA reports, particularly those which attempt a more general assessment of the Soviet economy, abound with emotive language and negative buzz-words: dismal, bleak, severe disruption, sluggish growth, malaise, stagnation. Moreover, when an economy's growth rate is declining, the growth rates of most of its individual branch outputs are also declining. The sequential reporting of decline after decline in individual sectors of the economy creates a cumulative effect that is greater than the average of its parts. The result may be to leave the reader with the feeling that the Soviet economy is in more desperate straits and headed to a more catastrophic future than the analyst may wish to imply (see Appendix D for an analysis of the tone of CIA reports to the Joint Economic Committee).

Clearly, it is important that policymakers read the intelligence reports written by the CIA. But this should not be accomplished by spicing up reports with racy, imprecise language that is more appropriate for a popular journal than an intelligence agency. The Panel strongly urges the CIA to avoid the use of emotive words, even if it makes for less sparkling prose. The Agency should use instead cool, precise, calibrated, and unambiguous language. An intelligence agency

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cannot always control the message that policymakers will receive, but it can do something about the tone and precision of the message that it sends.

Before leaving the general area of communication, the Panel wishes to commend CIA on its publications of Soviet national accounts. On the whole, the presentation of methodology, procedures and results in the published studies are models of clarity and openness. These studies demonstrate the high technical competence and sophistication of the SOVA analysts. Moreover, the unclassified publication of most of these studies represents a major contribution to the field of Soviet studies and to the enlightenment of the educated public on these matters. The profession and the public would be severely deprived, it is fair to say, if this open publication policy were changed. And the CIA, in turn, would be deprived of the valuable feedback from the users of its published data in the scholarly community. The Panel recommends that CIA maintain its production and open publication of Soviet national accounts and other Soviet economic data.

7. Underdeveloped Areas

The Panel recommends that CIA expand its efforts and commit resources to the areas discussed in this section of the Report.

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a. The Second Economy

Without a proper evaluation of the increasing role of the second economy, we are now likely to receive an incomplete picture of the economic situation and changes over time in the Soviet Union. This may result in an understatement of Soviet consumption levels as well as introducing errors in CIA analyses of labor productivity, incentives, real income and income distribution.

The Panel feels that the CIA is devoting insufficient attention to the second economy. While various CIA studies refer to numerous second-economy type activities and offer anecdotal evidence, no attempt at generalization or of placing the second economy in the general analytical framework has been made.

It is probably premature to start constructing Soviet GNP accounts which would fully incorporate second-economy type transactions, but preparation of a separate set of accounts (net and gross) for the second economy is highly desirable.

b. Social Indicators

In light of the recent decline in economic growth, particularly the growth of consumption, the Panel feels it is

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important for CIA to develop a set of social indicators that would help shed light on the changes in quality of life and the effect of slow growth on system stress. These indicators would include mortality and morbidity statistics and such socio-demographic indicators as marriages and divorces, births and abortions, alcoholism, mental health, crime, and the like. The development of a theoretical framework for analysing the links among economic, political, and social events, suggested previously in this Report, would further help identify social indicators useful to collect.

c. Regional Dimensions

In surveying the otherwise excellent CIA studies of consumption and other issues related to Soviet people's welfare, the Panel was struck by a persistent neglect of the regional dimensions of the subjects covered. The CIA has clearly recognized the importance of ethnic and nationality issues in the USSR, but this recognition has not been extended to regional economics. In the study of slow growth, quality of life, and system stress, regional differentials are of importance. What may appear to be an adequate index or measure for the nation as a whole may conceal critical shortages in certain geographic regions or republics, and these may lead to increased ethnic frictions, affect the pattern of migration

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flows, and influence government allocation consumption and investment funds.

d. Soviet-East European Relations

CIA has been paying insufficient attention to Eastern Europe and CMEA relations. It has now become important for the Agency to gain more of a CMEA perspective on a number of issues--energy, trade, agriculture, and technology. There is already a recognition of this problem by CIA with the establishment of a new research effort on CMEA topics.

The organizational split between responsibility for the Soviet Union (SOVA) and Eastern Europe (EURA) has created conditions that may improve the quantity and quality of work on Eastern Europe. But there are inevitable interface problems which have to be attended to if a CMEA focus is to be established and maintained.

e. Sources of Data

The Panel notes that in the last 4-5 years, the Soviets have been withholding from publication an increasing amount of important economic data and that Soviet authorities have increased restrictions on the sending of printed matter from the USSR. It is regrettable that, for procurement of Soviet

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data, the CIA relies on US Embassy personnel, libraries and commercial outlets in the West and on occasional visits to the USSR by US scholars and exchange students. It would be desirable for CIA to explore the possibilities of alternative sources of supply of Soviet data and/or of expanding and strengthening existing channels for a systematic retrieval of Soviet data.

f. CIA-Academia Relations

The Panel believes that the expansion of relations between CIA and the academic world is important for maintaining and increasing the quality of CIA work. CIA analysts on the Soviet Union do participate in professional conferences and do publish articles in the triennial JEC volume on the Soviet economy and sometimes in professional journals. And groups of outside specialists are on occasion invited to the Agency for discussions with CIA analysts. The Panel feels that these contacts should be increased.

The Panel believes that it would also be useful for the CIA to reinstate its policy of open publication of unclassified reports that it suspended about a year and a half ago. The Panel realizes that several CIA publications in the past generated considerable controversy and public debate. It is understandable that the Agency should wish to avoid being the

CONFIDENTIAL

target of public criticism, some of which is uninformed and ill-willed. Staff members are too busy to respond to all or even most of the critiques; often security considerations prevent a point-by-point rebuttal. However, some of the criticism has also been helpful. It has stimulated reconsideration of the analysis and the underlying evidence and has sensitized managers and staff to key issues and new developments. Because CIA is the only intelligence community organization with significant competence in Soviet economic affairs, and is thus by far the dominant source on this subject within the government, it is particularly important that the Agency's intelligence product should be submitted, insofar as security considerations permit, to the test of external scrutiny in the general community of Soviet specialists.

Conference attendance and open publications have a direct bearing on raising the quality of CIA's output. These activities are also critical measures of professional self-identification, and are therefore significant in recruiting and retaining quality staff. With the experience it has just had of reviewing the broad scope of recent CIA work on the Soviet economy, the Panel believes that greater intellectual outreach, interaction and even competition with the outside professional community are important for the improvement of the Agency's analytical product.

CONFIDENTIAL

APPENDEXES

CONFIDENTIAL

Appendix A

25X1

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Appendix B

INDEPENDENT REVIEW AND
ANALYSIS OF SOVIET ECONOMIC PROSPECTS:
Statement of Mission and Objectives
January 25, 1983

- I. OBJECTIVE: An independent review and analysis of U.S. intelligence findings on Soviet economic capabilities, problems and prospects.
- II. ORGANIZATION: The PFIAB has requested that the Department of Commerce undertake this study. To accomplish the review, two groups are formed:
 - o Commerce Steering Group
 - o Working Panel

III. COMMERCE STEERING GROUP

Task: To provide a written charter which both establishes the Working Panel general objectives and specifies certain key issues to be included in the review; to review the work of the panel in order to assure its relevance and consistency with the objectives of the project.

Composition: The Steering Group will be composed primarily of Commerce Department officials. Interagency representation is not an objective; however, persons from outside the Department or outside the Executive Branch as required may be selected to ensure a full range of Steering Group expertise.

IV. WORKING PANEL

Task: The basic tasks of the Working Panel are: (1) to assess the validity of the intelligence community's findings, interpretations and conclusions derived from its forecasts of the Soviet economy; (2) to evaluate methodological approaches and underlying assumptions used by the intelligence community in the calculation of Soviet GNP, economic growth rates, and other key economic indices of Soviet economic performance; and (3) to examine the clarity with which these forecasts, interpretations, and conclusions are presented to policy-makers.

The tasks will neither require original research nor include the development of foreign policy options. The final report of the Working Panel will be presented as a consensus document.

The portion of the task assessing the validity of the intelligence community's findings and conclusions on the

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Soviet economy--reflecting analyses developed over an extended time period--will include the following:

- o an evaluation of the consistency of interpretative findings and conclusions with the available data and relevant qualitative assessments;
- o the presentation of an alternative assessment(s), if any, of Soviet economic prospects with an evaluation of the confidence attached to this assessment(s).

The portion of the task relating to methodological issues will include the following:

- o the review of major intelligence economic analyses of Soviet growth prospects, with special emphasis on methodological approaches and the underlying assumptions used to calculate Soviet GNP, economic growth rates, and other key economic indices;
- o an appraisal of the validity of these approaches and assumptions, and the degree of confidence which can be attributed to the results produced
- o the sensitivity of Soviet economic forecasts to changes in major underlying assumptions;
- o the identification of specific omissions/weaknesses in existing methodologies and assumptions, with suggestions for new directions or analytical approaches where applicable.

Finally, the task dealing with the examination of the clarity of presentation will include:

- o review the techniques and means by which policy makers are given a sense of the degree of confidence that can be attributed to forecasts;
- o to the extent practical, review the techniques and methods for communication of analytical findings and determine whether the general perceptions conveyed by written reports are those intended.

Composition: A small group of individuals recognized for competence in analysis of the Soviet economy and international affairs; one of the group to act as chairman, tasked with organizing and directing group efforts and producing a final report, responsibilities demanding a major portion of his time over the life of the project.

V. CONDUCT OF THE REVIEW

Timing (Revised): the report is to be submitted to the President's Foreign Intelligence Advisory Board (PFIAB) by

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July 1, 1983. Interim steps leading to completion of the report would include the following:

Jan. Feb. Mar. April May June July

Steering Group-Working Panel's discussion of conduct of the review and the specific questions for CIA response and Working Panel's analysis

X

Working Panel's meetings as required

X X X X X X

Mid-term Steering Group-Working Panel review of progress and problems encountered, if any

X

Preparation of draft report

X X

Steering Group-Working Panel's review/discussion of the draft report to allow Steering Group requests for clarification, amplification, etc. (The Steering Group may be expanded for purposes of this review, to include other government experts.)

X

Submission of final report to PFIAB

X

Steering Group-Working Panel Relationships: The Working Panel is responsible for the organization and conduct of the review leading to submission of the report requested by the PFIAB.

The function of the Steering Group is to set the directions of the review, monitor progress, provide the Working Panel necessary support and ensure that the report is consistent with the objectives of the charter.

To facilitate timely completion of the report, efficient use of the Working Panel's time, and to provide focus for its efforts, a set of questions dealing with issues to be examined by the working panel will be prepared. These questions will be forwarded by the Steering Group to the CIA for their responses.

Upon completion, the CIA responses will be provided to the Working Panel for their review according to the guidelines in this charter.

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The Working Panel may range beyond the specific questions transmitted to the CIA, identifying and examining other issues not adequately treated in existing research or analyses.

Logistical Support

The Department of Commerce will provide necessary analytical, administrative, logistic, and data support to the Steering and Working Panel groups; the number and composition of personnel will depend on the demands of the groups, but will include an Executive Secretary responsible for liaison with and providing Departmental support to both groups.

Role of the Executive Secretary: The Commerce Department provided Executive Secretary will work closely with the Working Panel to facilitate efficient, timely completion of its work.

The Chairman of the Working Panel may, at his discretion, task the Executive Secretary with:

- o drawing on internal DOC expertise on the Soviet economy;
- o arranging meeting dates and places, notifying Panel members, preparation of agenda, etc.;
- o providing secretarial services for preparation of minutes of meetings, draft and final reports, etc.;
- o providing specific data and/or analyses that may be required;
- o providing day to day liaison with the Steering Group, the CIA, other government agencies, etc.;
- o formulation, drafting, review, or editing of administrative or substantive papers relating to the Panel's work or segments of its report; and
- o other appropriate administrative, logistical, data collection and liaison functions relevant to the Panel's mission.

Confidentiality: The existence of the Working Panel, its mission and deliberations, content of the report, and all associated matters are to be treated by all participants as classified information and are not to be revealed to unauthorized persons.

Working Panel Report: The final report should be a synthesis document highlighting key conclusions and recommendations, suitable for high level executive reading.

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Appendix C

25X1



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Appendix D

TONALITY IN C.I.A. REPORTING

A Study of Tone of Communication
in the
Annual CIA Statements
to the
Joint Economic Committee
1977-1982

1. Introduction.

Among the items read by the Panel were the annual Agency statements to the Congress, generally titled, "Allocation of Resources in the Soviet Union and China." These documents, presented from 1977 through 1980 by Stansfield Turner and in 1981 and 1982 by Henry Rowen, summarize the conclusions of the CIA about the performance of the Soviet economy. They thus appear to represent a fair statement of Agency conclusions on the Soviet economy across time.

By and large, the reports from 1977 through 1981 left the impression on most members of the Panel that the Agency perceived the Soviet economy as in a "state of crisis", while the 1982 report, with its much greater emphasis on the strengths of the economy, suggested a Soviet economy in trouble, but with considerable capacity for adjusting to difficulties and somehow "muddling through." At the same time, it is worth noting that CIA's quantitative forecasts of Soviet economic growth were lower in 1982 than in 1977.

To provide the Panel with a systematic basis for examining these changing Agency interpretations, the present study was undertaken. Its objective is to analyze, systematically, the tone of CIA judgments on key issues in the Soviet economy across time. To accomplish this, a combination of quantitative and qualitative textual analysis is employed. The quantitative aspect of the analysis is limited to the identification and recording, via special computer program, of the text of all statements about the key issues under study. This process makes possible systematic comparison and evaluation of Agency judgments while avoiding the biased selectivity that often accompanies qualitative analysis. Qualitative comparisons are then made regarding two matters of interpretation: (a) the degree of severity of the problem under study; and (b) prospects for either dealing with or overcoming the problem. Agency judgments are examined respecting the following four issues (as identified by the occurrence in the texts of the indicators noted in parentheses): Performance of the economy

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(GNP, economic growth, economic performance), Consumption (consumption), Energy production and conservation (energy, conservation), and Dependence on the West (trade, import).

2. Performance of the Economy

The 1977 Agency report contained only two judgmental statements about the current levels of Soviet economic performance. The first noted that "things have not been going well for the Soviet economy recently," while the second observed that "GNP has been trending downward." While these appear to be temperate judgments consistent with the data presented, from the text it is not clear that what is "trending downward" is not GNP but the growth rate of GNP.

Judgments made in the 1977 report about future prospects for economic performance stress the expectation of continuing slowdowns in economic growth through the mid-1980s. The major source of the economic slowdown is seen as the anticipated "sharp slowdown in energy production." While noting that "forecasts for Soviet economic growth must take account of the uncertainty in the future trends and the policy options available to the Soviets," the report, in its projections, conveys an impression of substantial pessimism, based upon a sense of severely limited Soviet options. The following statements are typical.

"Soviet energy consumption has closely paralleled the growth of the economy, as a result, a sharp slowdown in energy production threatens to constrain economic growth unless Moscow succeeds in conserving massive amounts of energy and/or allows a major turnaround from a net export to a net import position on energy trade."

"Even a combination of measures to sustain investment coupled with measures to obtain additional manpower would probably raise economic growth only slightly."

"Let me emphasize that these are average figures: performance in some years could be better, but also worse, with zero growth or even absolute declines in GNP a real possibility if oil shortage and a bad crop year coincide."

Energy output continued to be perceived in the 1979 report as the key factor in reduced growth, accounting for at least one percentage point of the projected decline; and the decline in the rate of growth in the 1980, was seen as inevitable.

The 1980 Agency report evaluated the Soviet economic outlook as "grim," and the economic reforms thus far adopted as having "no appreciable effect." Moreover, it suggested that a "significant boost in economic growth cannot be achieved without major structural reforms," implying an almost complete

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lack of options within the framework of the present Soviet system. Beyond these assertions, however, most of the judgments in this report focused on current trends in the economy. Each of the relevant statements was limited to simple description, containing little evaluative content. The following are illustrative examples:

"...economic growth declined (in 1979) to its lowest rate since World War II."

"The decline in GNP growth...has been the result of a sharp reduction in the efficiency with which these inputs have been employed."

The 1981 Agency report characterizes the Soviet economy as in the "doldrums," and "worse than we anticipated." Economic growth is described, once again, as "at its lowest level since World War II." In contrast to previous years' projections, however, the 1981 report suggests at least the possibility of some rebounding of economic growth, though it forecasts that "even with a return to more normal harvests, we expect problems in industry and other sectors of the economy will cause GNP growth to fall to about 1.5-2 percent per year by the mid-1980s." Rather than energy being cited as the key variable in an economic slump or upturn, now the focus is on the Soviet harvest:

"It should be stressed that these figures are just averages. In poor harvest years, GNP could actually decline, while in bumper crop years growth could be as high as 3-4 percent."

While the 1981 report adopts a generally negative tone on the issue of economic performance, and continues to see improvement as unlikely, it nevertheless lacks the dogmatic sense of the "inevitability" of continuing decline of the 1979 report.

The 1982 Rowen report is distinguished from each of the earlier reports examined not by differences of fact, or even of assessment of problems the Soviet economy faces in sustaining economic growth. Rather, this report differs from its predecessors in its deliberate use of comparative analyses to provide a more balanced basis for drawing inferences about the meaning of figures cited. Moreover, the report, for the first time, is explicit in setting limits to the implications that should be drawn from its findings.

The pattern of slowdown in economic growth predicted in the early reports and observed in later ones is reported again in the 1982 study, in words almost identical to those used earlier: "The average annual rate of increase in GNP was about 6 percent during the 1950s, 5 percent during the 1960s, and

CONFIDENTIAL

nearly 4 percent between 1970 and 1978. In 1979-1981, yearly growth averaged less than 2 percent. This year we expect GNP growth to be about 1.5 percent."

The essentials of the analysis of why Soviet GNP has slowed remain the same as in earlier reports: "The slowdown partly reflects declining increments to the supply of labor and the stock of capital and sharply increased costs in producing and transporting vital energy and raw materials. But it also stems from the inability of the system to offset these constraints by bringing about substantial increases in efficiency and productivity."

Rather than the "severe," if largely unspecified difficulties for the Soviet economic and political systems implied by earlier reports, the 1982 study limits its projections of consequences to the prediction of "much harder choices for the leadership in allocating resources to consumption, investment, and defense."

Some comparative context is provided by noting that, "to a remarkable degree, the slowdown in Soviet economic growth has a parallel in OECD countries." Further comparative balance is provided by the observation that, "Soviet GNP in 1982 will equal about \$1.6 trillion, roughly 55 percent of US GNP this year. Per capita GNP is almost \$6,000." A similar sense of comparative perspective is offered when the report notes that "Western observers have tended to describe Soviet economic performance as 'poor' or 'deteriorating' at a time when Soviet defense spending continues to rise, overall Soviet gross national product in real terms continues to increase, and Soviet GNP is second in size only to that of the US." These statements mark the first time in these reports that Soviet economic performance, with the exception of defense spending, is compared with that of other nations.

To leave no doubt in the reader's mind regarding the basic resiliency of the economy, the study affirms that "in fact, we do not consider an economic 'collapse'--a sudden and maintained decline in GNP--even a remote possibility." "Indeed, we expect GNP to continue to grow, although slowly." The fact that the economy has performed "poorly" in comparison with its own past record of growth, the 1982 report asserts, "does not mean that the Soviet economy is losing its viability as well as its dynamism."

3. Consumer Welfare

The 1977 through 1981 Agency reports are unvarying in their conclusion that "the reduced growth potential means that the Soviet consumer will fare poorly during the next 5 to 10 years relative to his gains since the current leadership came to power." (1977) Similarly, each of the reports duly notes the

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difficult trade-offs between investment, defense and consumption, trade-offs made only more difficult by the perceived requirement that consumption levels improve if labor productivity is to rise. Even the 1977 report, which tends to have the most negative tone overall, expresses the belief that "consumer pressures will remain manageable."

Looking at possible policy options a successor leadership might face in the 1980s, the 1980 report proposes as one, "imposed austerity," under which "consumption would suffer and the draconian measures of the past might be needed to keep the labor force working." Alternately, a new regime might favor consumption over defense. Without choosing between these alternatives, the 1980 study makes clear that for the short term the Agency expects "the rise in living standards in the USSR will come to a halt." The tone of all the analysis regarding consumer welfare in the 1977 through 1981 reports is one that emphasizes anticipated declines in consumer well-being, and the likelihood that regime policies, rather than alleviating the consumer condition, will lead to its worsening.

After noting once again that "per capita consumption could level off or even fall slightly," the 1982 report observes: "It appears that consumer interests are now being treated somewhat less cavalierly." The evidence is that "breaking precedent," the 11th five-year plan calls for capital investment to grow more slowly than consumption. Such a change, in sharp contrast to the tone of previous reports' assumptions about the priority of the consumer in Soviet planning, it is suggested, "probably also stems from a political decision to protect Soviet consumers in a time of tightened economic constraints."

4. Energy and Energy Conservation

Energy, together with manpower, productivity, and agriculture, has been seen by the Agency as among the most significant factors accounting for the observed and predicted future slowdown in Soviet economic growth. Reflecting this view, energy as an issue received more attention in the annual statements (85 mentions), than any other question examined here. In spite of differences in details, the tone of Agency reports from 1977 through 1981 remained largely negative, focusing especially on the projected fall in oil production and its anticipated consequences. In 1982, however, with the analysis of the oil problem more flexible in setting dates for the onset of the oil decline, the tone of the Agency report changed dramatically in its assessment of energy production overall as a "plus" for the Soviet economy.

The essential Agency assessment of the Soviet energy problem is summarized in this 1977 statement:

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"Because of the continuing fall in oil production and even if the development of other energy resources--especially gas and coal--is pushed to the maximum, we expect a sharp slowdown in the rate of growth of total energy output."

The 1980 report, if anything, adopts a dimmer view on Soviet energy prospects. Asserting that the "worst problem" the Soviets' face is "energy," the report proposes that "a sharply declining energy growth will be the biggest new constraint on economic growth." In elaboration, the report projects a drop from a past 5 percent energy growth rate to 1 percent by 1985, "even if Moscow sharply raises the amount of investment in this sector--as seems likely." One consequence of this anticipated decline, "as energy production falters," is seen as "first a rapid fall, and then the disappearance of oil exports." Even Soviet gas exports, the report argues, "will not be enough to prevent the USSR's present surplus in energy trade from turning into a deficit."

The 1981 report once again affirms the Agency's belief in the essential validity of its 1977 projections: "our forecast in 1977, that Soviet oil production would peak no later than the early 1980s and then go into decline, remains essentially valid." In contrast to earlier reports, however, this one does give somewhat greater consideration to prospects that increases in gas and nuclear power may offset losses in oil production. For example, the statement notes, "with roughly one-third of known world gas reserves, gas output will contribute roughly 90 percent of the net increase in Soviet primary energy production during the 1980s." The report concludes, however, "despite the rosy outlook for gas output, the domestic economy will still be hard hit by the decline in total energy growth..." Considering the role of energy exports, the 1981 study suggests principally that "Moscow can cushion the effects of declining oil production and increasing demand for the next few years by cutting exports to the West, but the Soviets will have to choose between the need to export energy to pay for high priority imports and the direct requirements for energy in their domestic economy."

In contrast to these sharply negative interpretations and projections, the 1982 report shows that "overall, energy production might be considered a plus." The report goes on to note that production of all major forms of energy rose in 1982. Although the evidence on natural gas production and reserves seems to have changed only slightly (in 1981 Soviet gas reserves were reported as 1/3rd of world proved reserves, while in 1982 this figure was increased to 40%), the tone of statements, especially regarding gas's role as a substitute for oil, became more optimistic:

"Natural gas has been a major Soviet success story. It will play a pivotal role in meeting the energy needs of the

CONFIDENTIAL

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economy in the 1980s, particularly as a substitute for crude oil in industry and in home use but also as a potential hard currency earner."

The CIA reports identify four approaches the Soviets seem to be pursuing or might adopt to deal with their energy problem: (a) increase production of primary energy; (b) alter the energy balance; (c) modify the structure of exports; and (d) undertake extensive conservation measures. We will focus here on CIA's view of Soviet prospects for energy conservation. Overall, the Agency reports pay very little attention to prospects for energy conservation.

The 1977 report confines itself to a simple mention of the importance to Moscow of "conserving massive amounts of energy," while abjuring any judgment about the likelihood of success. The 1979 report notes that "some gains in energy conservation were achieved last year," but stresses the difficulty of achieving substantial savings. The 1980 report does not discuss the problem of conservation. The 1981 study addresses the issue in considerable detail, and concludes that "they will achieve only minimal success in conservation by the mid-1980s." The 1982 study does not cover the issue of energy conservation.

5. Imports: Capacity and Dependence.

The annual reports have varied in their attention to the issue of Soviet trade. In the 1977 report, the issue was referenced 8 times, but only 2 and 5 times respectively in the 1979 and 1980 studies. In contrast, the 1981 and 1982 reports each made 18 references to the issue. Each of the reports looked at the question of Soviet hard currency import capacity. Most of the attention in 1977 and 1979 was focused on the impact of the anticipated oil shortage on import capacity, particularly the anticipated trade-offs between hard currency imports and supplying Eastern Europe's energy needs, while the later reports gave more attention to grain and other Soviet imports.

The question of Soviet dependence on imports from the West is addressed only in the 1981 and 1982 reports.

The tone of reporting on Soviet import capacity mixes praise of actual Soviet trade accomplishments with warnings about anticipated future difficulties in sustaining the current level of trade. The 1977 report, showing the influence of CIA's oil output forecast, is the most negative regarding expected problems. It makes no positive assessments or statements respecting Soviet import capacity. Its tone is overwhelmingly gloomy:

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"The oil problem could have disastrous effects on the USSR's ability to import from the West."

"Most importantly, a looming oil shortage may create bottlenecks and will almost certainly force curtailment of critical imports from hard currency countries."

The 1977 study suggests that the Soviet oil crisis will create "added incentive to establish strong political influence on oil-producing states to secure oil imports on favorable terms." The report does note, however, that "achieving this objective will be very difficult."

In contrast, the 1979 report finds the USSR's ability in the previous several years to continue to make large hard currency outlays for grain to support its livestock program "The one area in which the Soviets have achieved a major success." At the same time, this study argues that, if Agency oil projections are correct and if Moscow "continues present policies," the USSR "will be hard pressed to even maintain their hard currency import capacity."

The tone of the 1980 report is almost identical to that for 1979. The USSR's "trade and payments situation" is described as "a bright spot in the Soviet economy." At the same time, the study repeats its prediction that by the late 1980s, even "the additional hard currency generated by using gas exports will not be enough to prevent the USSR's present surplus in energy trade from turning into a deficit."

In the 1981 report, improvements in Soviet import capacity are described as "large windfall gains," rather than as a "bright spot." Instead of emphasizing the improvement in Moscow's financial position, as in the 1980 report, the 1981 study argues that the "favorable shift in the terms of trade" has enabled the USSR to "turn to the foreign trade sector for relief from its domestic problems." Looking at future import capacity, the report observes that "we expect Moscow to close out 1981 with a current account surplus, albeit one much reduced from the 1980 level." Moscow's trade position is described as having "taken a turn for the worse, and future deterioration may be in the offing." The report states that "if the trade trends evident since 1979 continue, the USSR could experience a decline in its hard currency exports before the mid-1980s."

The 1982 report adopts a more cautious, balanced tone on this issue, as on most others. Rather than specific expectations of "declines" in hard currency earnings, the study suggests that "primarily because of the softening of energy prices, Soviet terms of trade vis-a-vis the West will be less favorable in the 1980s than they were in the 1970s." Respecting current import capacity, the report notes a

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"substantial improvement in the current hard currency balance of trade." This positive assessment is based not on an expected Soviet hard currency trade surplus in 1982, but on the expected reduction by 50% of the hard currency trade deficit compared with the previous year.

The 1981 report contains only one reference to the issue of Soviet dependence on imports from the West: "Without agricultural imports the Soviet diet would have deteriorated." the importance of Soviet imports of steel and machinery is noted in this and earlier reports, but only in general terms, with no attempt to deal with the "dependence" aspect of the problem.

The tone of the 1982 report balances observations of the "importance" and even "critical" role of some Soviet imports with assertions of the essential "viability" of the economy in the absence of such imports. The most important change in tone, however, arises from an effort to examine the benefits, or advantages of trade to the Soviet economy, as well as the costs of trade. This new tone is evidenced in the following statements from the 1982 study:

"Imports, particularly from the West, can play an important role in relieving critical shortages, spurring technological progress, and generally improving Soviet economic performance." "Imports from the West have become critical to the Soviets efforts to improve, or simply maintain, the quality of the Soviet diet."

"The Soviets now must rely on western imports of capital and technology to increase or maintain production of some of the raw materials in which they are abundantly endowed and self-sufficient."

These statements are placed into a larger perspective with the observation that "the ability of the Soviet economy to remain viable in the absence of imports is much greater than that of most, possibly all, industrialized countries."

6. Conclusions.

This study has sought to document the considerable variations in tone across a series of annual Agency reports. The essential pattern is one of emphasis on substantial anticipated difficulties in the 1977 through 1981 reports. The 1982 study, in contrast, creates a very different impression through the way in which evident problems are placed in a fuller, comparative context.

CONFIDENTIAL

Appendix E

A NOTE ON THE ACCURACY OF
GNP DATA NEEDED FOR DECISION-MAKING

Although it is impossible to establish general rules for margins of error in macroeconomic data that can be tolerated in decision-making, it is possible to offer some background that may provide perspective.

In the United States, national income and product statistics consist of a series of successive approximations based on increasingly complete and reliable information. Unofficial current quarterly estimates, seasonally adjusted, are prepared 15 days before the end of each quarter and official estimates 15, 45, and 75 days after the end of the quarter. Annual estimates for each year (besides those obtained at the end of the year as the sum of quarterly estimates) are published in each of the three or four following Julys, and result in further revisions of quarterly series. About every five years a benchmark revision--stemming mainly from information that becomes available infrequently or with a long lag--is introduced, and this again changes the annual and quarterly numbers. Minor changes occur even later. GNP estimates are constructed both as the sum of expenditures for final products and as the sum of national income and other charges against GNP. These estimates serve to check one another as well as to provide different information. Insofar as they cannot be reconciled, differences appear as the statistical discrepancy in the national accounts.

Final data are considered accurate but the error in them (as in other statistics) cannot be actually measured. The revision record can, however, be studied; it does, to a certain extent, provide an indication of the error in GNP data used by US policymakers. In the 1964-69 period the average revision in the quarterly rates of growth, expressed at annual rates, from the first (+15 day) official estimate to the third July revision was 1.0 percentage point for current-dollar GNP and 1.4 percentage points for real (constant-dollar) GNP. One-tenth of the time the revision lowered the growth in the current-dollar GNP by 2.1 percentage points or more, or raised it by 2.3 percentage points or more; corresponding figures for constant-dollar GNP were 2.0 and 2.9 percentate points.(1)

How often did the seemingly large errors in preliminary estimates affect appraisals of the economic situation on which

(1) Note that, as in Commerce Department press releases, these percentages refer to changes expressed at annual rates, which are four times as big as revisions in actual changes in GNP from quarter to quarter.

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policymakers relied? The Advisory Committee on Gross National Product Data Improvement, reporting in 1977, found that "In the three decades (120 quarters) following the end of World War II, major revisions affecting appraisal of the overall state of the economy have occurred on seven occasions."² Three of the errors were initial overstatements of the declines in GNP shown by one or both of the GNP measures in the recessions of 1948-49, 1953-54, and 1957-58. Fourth, the strength of expansion in 1965 was initially understated. Fifth, the impact of recession on corporate profits in 1969-70 was understated. Sixth, the initial estimates for the first three quarters of 1971 overstated the buoyancy of the recovery from the 1969-70 recession. Seventh, initial estimates understated the buildup of nonfarm inventories in the winter of 1973-74 and understated farm income and increases in farm inventories all during 1973. The principal error disclosed by revisions since the committee report was issued consisted of understatement of private saving and investment, and of corporate profits, beginning in 1973; this error was eliminated only in the December 1980 benchmark revision and the July 1982 revision.

All seven of the revisions that the committee viewed as affecting appraisal of the overall state of the economy refer to expansions and corrections over the course of the business cycle, fluctuations in either total GNP or its cyclically sensitive components. Accurate knowledge of current cyclical movements in the domestic economy is important for governmental formulation of stabilization policy and for business decision-making. Knowledge of similar movements in most other major countries is of interest because these movements may affect our foreign trade and investment. However, we have no similar need for current short-term macro information about the Soviet economy. The USSR does not display short-term demand related expansions and contractions such as are typical in the West, and the US would have no responsibility for its stabilization policy even if it did. Our trade and investment with the USSR have been too small to affect economic fluctuations in our own economy. Agriculture is the exception to this statement, and farm production is subject to large irregular movements; however, less-than-annual data can be constructed for farm production only by convention. The United States does not need, and CIA does not provide, quarterly GNP estimates for the USSR. Even annual data are needed (except for agriculture) mainly to keep analyses of longer term trends up to date.

(2) Gross National Product Data Improvement Project Report. Report of the Advisory Committee on Gross National Product Data Improvement, October 1977. Issued by the Office of Federal Statistics Policy and Standards, U.S. Department of Commerce.

CONFIDENTIAL

CONFIDENTIAL

51

Of the important revisions in the United States estimates since World War II, only that of saving and investment after 1972 was of possible importance for analysis of longer term developments in the economy, or in economic policy other than stabilization policy.

The margin of possible error in the CIA's annual series for the USSR is unknown, but undoubtedly it is larger than that in the annual GNP series for the United States. However, it is likely to be less than the revisions in the first estimates of quarterly rates of growth (at annual rates) in the USA, and thus may not distort general appraisals of Soviet economic performance.

Another approach to the issue is presented in the following table, which compares growth rates of output per employed person in seven major countries. The USSR is shown to have raised this measure of economic performance much less than

Growth Rates of Gross Domestic Product per Employed Person, Selected Countries and Periods

	<u>Subperiods</u>			
	(1) 1948-81	(2) 1948-73	(3) 1973-81	(4) Decrease ((2)-(3))
Japan	6.3	7.6	2.9	-4.7
Germany	4.5	5.2	2.5	-2.7
France	4.1	4.7	2.4	-2.3
USSR	2.8	3.3	1.4	-1.9
United Kingdom	2.2	2.5	1.3	-1.2
Canada	1.9	2.6	0.1	-2.5
United States	1.6	2.1	0.2	-1.9

Source: All except USSR from U.S. Department of Labor, Bureau of Labor Statistics, Bulletin 2172, p. 69. USSR based on CIA and Bureau of the Census estimates. Output is labeled gross national product but method of estimate, is more appropriate for gross domestic product. USSR estimates for 1981 are approximate.

CONFIDENTIAL

CONFIDENTIAL

52

Japan, Germany, or France but more than the United Kingdom, Canada, or the United States. The table also shows that all of the countries experienced very large drops in their growth rates after 1973.

To alter this assessment of comparative Soviet growth, large changes in the CIA estimates for the USSR would be required. For example, the 1950-81 Soviet growth rate would have to be raised 48 percent to bring it up to the next-highest of these countries, or lowered 23 percent to bring it down to the next-lowest.

CONFIDENTIAL

SUBTOPIC EVALUATIONS
AND RECOMMENDATIONS

CONFIDENTIAL

SUBTOPIC EVALUATIONS AND RECOMMENDATIONS

I. National Accounting1. Introduction

By national accounting we mean measurement of economic activity of the economy as a whole and of its major component elements. This activity is conceptualized as a set of annual flows in a GNP model of the economy.

We view the boundary between the purview of this subcommittee and that of others, particularly "growth", as defined by the difference between the problems of measurement and those of interpretation of the results. The line is not neat, but it is probably serviceable for present purposes.

Any intelligence organization concerned with the economic health, progress, and prospects of a foreign state will need to be concerned with national accounting indicators for that state. The national accounts provide a general prism for examination of economic activity. Given the policymaker's concern with Soviet military economics and foreign trade

CONFIDENTIAL

CONFIDENTIAL

55

Subtopic Evaluations and Recommendations (cont.)

behavior, given his interest in the effect of economic progress or stagnation on Soviet internal stability and external expansion, the U.S. intelligence community must be able to provide comprehensive and reasonably up-to-date measures of Soviet economic activity set in the framework of national accounting. For the past few decades, the CIA has been the only organization in the intelligence community with the experience, knowledge and human skills required to perform the task. It is unlikely that any other element of the community will be able to supplant the Agency in this area in the indefinite future.

2. Methodologya. National Accounts in a Given Year

The subcommittee has not examined CIA's most recent report, Soviet Gross National Product in Current Prices, 1960-80. Therefore, our observations concern only the current price accounts for 1970, previously published.

The CIA GNP accounts at current prices represent a continuation and particular refinement of the accounting and valuation framework first developed by Abram Bergson. As such, they seem entirely appropriate to the requirements.

CONFIDENTIAL

CONFIDENTIAL

56

Subtopic Evaluations and Recommendations (cont.)

The CIA accounts are centered on the estimation of GNP. It would be useful, in addition, to have measures of Net National Product and National Income. Moreover, there is much to be said for calculating Net Material Product. This would permit direct comparison with Soviet official statistics. The series is also of interest because it measures output by the definition that the Soviets themselves use to appraise their performance.

At established prices, a key problem for Western estimation of Soviet national accounts concerns the role of the second economy. Clearly, some elements of second economy activity are already accounted in the CIA studies; other elements should not be (e.g., income from activities universally declared illegal, such as murder-for-hire). The most interesting questions concern activities that are legal by most Western standards, but are illegal in the USSR. The national income implications of the study of the second economy were debated a few years ago. It is probably desirable to reconsider that question in the light of the increasing flow of information on and quantitative measures of the second economy.

SOVA's factor cost adjustments of flows at current established prices represent a substantial improvement over the estimates by Abram Bergson and Abraham Becker (or by most other

CONFIDENTIAL

CONFIDENTIAL

57

Subtopic Evaluations and Recommendations (cont.)

western scholars), inasmuch as they use the 1972 input-output table to calculate the adjusted flows.

The subcommittee suggested to SOVA analysts that it may be timely to consider conceptual and empirical development of a valuation system additional to adjusted factor cost, namely, market prices. The question is raised by consideration of the significance of second-economy phenomena in the USSR and the evidence of market prices developed in Western studies of the second economy which would serve as the empirical basis for estimation. In view of the limited resources available in SOVA for research on Soviet national accounts, the Agency might wish to consider using external contracts.

b. Growth Indexes

CIA estimates GNP growth from the sector-of-origin side by extrapolating sector value added in the base year by indexes of production. The Agency recognizes that this is not the usual method but justifies its procedure on the grounds that the methods of deflation are not practicable for the USSR because of lack of information. The 1982 JEC study, USSR: Measures of Economic Growth and Development, 1950-80 provides a considerable discussion of the conceptual differences and implications. It has been suggested to SOVA analysts that they explore an alternative approach, modified commodity flow, which

CONFIDENTIAL

CONFIDENTIAL

58

Subtopic Evaluations and Recommendations (cont.)

consolidates the stages of fabrication of manufactured goods and thus provides a more appropriate weighting system.

The CIA time series are intended to approximate measures of production potential. A closely related complementary concept would be command over goods and services resulting from current production. This would require deflation of net exports by import prices, as opposed to subtracting imports deflated by import prices from exports deflated by export prices. It would be useful to determine whether this measure can be implemented empirically.

c. International Comparisons

The methodology is similar to that of the International Comparison Project headed by Irving Kravis and is, thus, state of the art. The issues of national accounting methodology both at a point in time and over a time interval that were raised above also apply here.

3. Empirical Estimation Problems

a. National Accounts in 1970

Given the limitations of information from Soviet sources, which have become more troublesome since the mid-1970s, it is

CONFIDENTIAL

CONFIDENTIAL

59

Subtopic Evaluations and Recommendations (cont.)

not surprising that there are a number of gaps and uncertainties in the estimates. Among the most important murky areas are changes in the cash hoards, accounting treatment of prison labor, the treatment of operating subsidies by unprofitable enterprises, the reconcilability of independent CIA estimates of Soviet defense spending with the GNP accounts, and the accounting treatment of foreign transactions.

Subsidies to agriculture have become more variegated as well as larger in recent years. It is not clear that the CIA estimates fully account for the subsidization of agricultural inputs--machinery, fuel, electric power, and fertilizer.

CIA has discussed in detail the reconciliation of its estimate of defense spending with that of GNP in only one paper (USSR: Toward a Reconciliation of Marxist and Western Measures of National Income, October 1978). This reconciliation is somewhat outdated now and moreover does not deal with the so-called "broad" definition of defense, designed to approximate Soviet perceptions more closely, which would include such components as outlays on construction troops and civilian space R & D. The CIA should undertake an up-dated reconciliation.

The Agency should also reconsider the possibility of breaking out inventory investment from its public sector

CONFIDENTIAL

CONFIDENTIAL

60

Subtopic Evaluations and Recommendations (cont.)

residual. This is an important magnitude and, therefore, some effort to overcome information gaps would be worthwhile.

b. Growth Indexes

As the Agency acknowledges, the effect of estimating time series of value added by extrapolation on the basis of quantity indexes may be to understate growth due to quality change and sample representativeness. There are possibilities for a countervailing bias due to the use of selected gross value of output data for several machinery subbranches. It has been suggested in a Department of Commerce study (Boretsky, et al.) that application of the CIA procedures to the national accounts of both the FRG and the US produces growth rates below those calculated by the statistical agencies of those two countries with the standard methods of deflation. The Panel does not endorse this study, but believes it should be carefully reviewed by the CIA.

The CIA notes that the end-use residual (GNP less the sum of deflated consumption plus investment) behaves peculiarly after 1978. This may be due to overestimation of the growth of consumption or investment (as an alternative to the conclusion that GNP growth has been underestimated). It would be advisable to restudy the problem and the possibilities of deflating new fixed investment, now largely taken from Soviet

CONFIDENTIAL

CONFIDENTIAL

61

Subtopic Evaluations and Recommendations (cont.)

statistics, in view of the mounting evidence of the inflation in Soviet investment prices. A particular issue here is the treatment of imported machinery, whose prices may have risen substantially during the second half of the 1970s.

If the current studies of the 1982 price reform are at all fruitful, the Agency should attempt to develop price indexes for at least major benchmark years to deflate end-use components more systematically and then to develop deflators for the sector-of-origin series.

c. International Comparisons

The Panel notes that CIA implied comparisons of the size of US and USSR national output are more favorable to the USSR than Soviet official calculations show. It has been argued that the problem lies in understatement of the general qualitative superiority of the American goods and services used in the price comparisons. The CIA should examine this apparent anomaly.

On the other hand, the Panel is impressed with the state-of-the-art international price comparison methodology used by the Agency in its international comparison of consumption in the USSR. This involved extensive, detailed quality comparisons of Soviet and US consumer goods, including

CONFIDENTIAL

CONFIDENTIAL

62

Subtopic Evaluations and Recommendations (cont.)

the testing by US laboratories of almost 200 individual Soviet consumer goods purchased for the CIA in the Soviet Union. The Panel feels that when faced with a choice between evidence and impressions, it must go along with evidence. Until sufficient, equally thorough evidence is presented to counter the CIA estimates, CIA's international comparison calculations of consumption in the USSR should be accepted.

4. Communication

On the whole, the presentation of methodology, procedures, and results in the published studies are models of clarity and openness. These studies demonstrate the high technical competence and sophistication of the SOVA analysts. Moreover, the unclassified publication of most of these studies represents a major contribution to the field of Soviet studies and to the enlightenment of the educated public on these matters. CIA is to be highly commended for these open publications and it is to be hoped that this policy will be maintained in force. The profession and the public would be severely deprived, it is fair to say, if this open publication policy were changed. And the CIA in turn, would be deprived of the valuable feedback from the users of its published data in the scholarly community.

CONFIDENTIAL

CONFIDENTIAL

63

Subtopic Evaluations and Recommendations (cont.)

Our only criticism of the presentations is that given the multiple uncertainties and gaps in the underlying data, the Agency's self-appraisal of the results conveys somewhat more confidence in their reliability than is probably warranted. A somewhat more agnostic attitude would not detract at all from the overall evaluation of high professional quality at which most readers of these studies are likely to arrive.

5. Conclusion

Because of the centrality of the national accounts estimates to empirical work on the Soviet economy, we consider it important to stress the great desirability of continuing this work, adequately staffed and funded. We want to underscore our concern that research and publication in this area be maintained at its current high qualitative level.

CONFIDENTIAL

CONFIDENTIAL

64

Subtopic Evaluations and Recommendations (cont.)II. Growth Problems, Projections,
Organizational and Policy Change

The CIA has identified the principal sources of the growth rate decline and has devoted full attention to the analysis of those sources. Its growth forecasting record has been good and its long-run econometric forecasting model SOVSIM approximates the state of the art. It has closely monitored the ongoing organizational and policy changes and has endeavored to assess their success. It has identified the main policy options facing the leadership and has sought to forecast the likely choices among policy alternatives.

The Panel has a number of recommendations that may assist the Agency in its work on these matters and enhance the quality of the analysis.

1. The analysis of the growth rate decline would be advanced if the relative importance of the contributing causes could be assessed. In the absence of measures of relative importance, the explanatory system appears to be overdetermined; various subsets of causes seem sufficient to explain the decline fully, without reference to other causes. We recommend the exploration of the method of growth accounting for a more systematic quantitative analysis of the sources of the growth decline. A growth accounting framework would also

CONFIDENTIAL

CONFIDENTIAL

65

Subtopic Evaluations and Recommendations (cont.)

facilitate the comparison of the Soviet growth slowdown with the similar slowdown in the Western industrial countries, thereby enriching the analysis.

2. We have the impression that past long-run growth forecasts have tended to be somewhat on the high side. An analysis of the sources of the differences between past forecasts and actual performance as measured by the CIA would be helpful in improving the accuracy of future forecasts.

3. The SOVSIM model has served as a useful aid in medium-term and long-term forecasting and in simulating the effects of alternative assumptions and policies. Its limitations are understood by the analysts and described in the reports. We feel, however, that the results are presented with greater confidence than is warranted. In particular, we note the heavy emphasis on the energy-constraining mechanism, the absence of behavioral content in the model, and the dependence on assumptions about such significant exogenous variables as technological change. The degree of confidence in the results of the simulations, as communicated in the Agency reports, strikes us as too high in light of the limitations of the model. We recommend that the analysts devote more attention to the assessment of the levels of confidence to be placed on the results and to the communication of the appropriate confidence levels to the policymakers.

CONFIDENTIAL

CONFIDENTIAL

66

Subtopic Evaluations and Recommendations (cont.)

4. SOVSIM should not be regarded as the sole forecasting instrument but as an aid in the process of forecasting along with less sophisticated techniques, experience, and judgment. At times, CIA has preferred to submit multiple scenarios to policymakers rather than commit themselves to one specific forecast. Economic forecasting is a difficult business and can even at times become detrimental to solid analytical research. However, the discipline imposed by forecasting does have certain advantages. First, one cannot forecast without dealing with behavioral issues. Analysts must argue over behavioral specifications and resolve their differences by observation and empirical tests where possible. Second, forecasting and retrospective evaluation helps in the allocation of scarce analytical resources. It identifies where past errors were most serious and where current research should be concentrated. Third, the presentation of multiple scenarios to policymakers is often interpreted as an implicit forecast anyway. Policymakers will apply their own probability weights to alternative outcomes, and their assessment of likelihoods is seldom as informed as those made by the analysts.

5. An important part of the Agency's work is the forecasting of economic policies and structural reforms. We have not found any extensive analysis by the CIA of the probable effects of the policy and systemic changes that may be entertained by the new leadership. It would be useful, for

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

example, to consider the alternative forms that a Hungarian-type reform might take in the USSR and the inferences that can be drawn from the Hungarian experience about the benefits and the problems that would ensue. The Agency has addressed the question of whether a hard line or a soft line is more likely to be adopted, but the analysis is very brief and sketchy and not tightly argued. It would be helpful to try to work through the possible effects of both of those policy lines, informally by qualitative and quantitative analysis and formally by SOVSIM simulation. It would help the Agency to sharpen its analytic apparatus by identifying and assessing those policies that in its judgment would best contribute to the acceleration of the Soviet growth rate.

6. The evaluation of past organizational changes and reforms is clearly a difficult task. In any economy most such changes yield small positive results that are difficult to isolate from other influences and difficult to measure. But a large number of small improvements may make a significant difference over time.

It is our impression that the Agency tends too readily, in its discussions of organizational changes, to disregard effects that, though small, should be regarded as significant. When quantitative estimates of policy or organizational changes are made, small positive effects of the order of 0.1% to 0.5% are

CONFIDENTIAL

CONFIDENTIAL

68

Subtopic Evaluations and Recommendations (cont.)

sometimes treated by CIA analysts as negligible. For example, a policy that would raise Soviet per capita consumption by 0.5 percentage points per year (from 0.8% to 1.3%) was thought not to be significant because differences in per capita consumption of such magnitudes would be barely perceptible. Such judgments reflect a misunderstanding of the limits of economic policy in any economic system. The following remark by John Kendrick (AER, May 1980, p. 233) is illustrative:

"We should not be discouraged, however, when any given policy measure is estimated to produce growth effects of only 0.1 or 0.2 percentage points. When a number of such complementary policies are pursued, the combined effect can sum to one or more percentage points which, when compounded, can make a very big difference to the long-run economic outlook of the nation."

7. When the Agency's assessments of policy and organizational changes are based on qualitative evidence, the assessments also tend to be excessively pessimistic. Sometimes that tone is communicated by the improper use of anecdotal evidence of wastefulness and static inefficiency as part of the explanation of the growth-rate decline; evidence of inefficiency cannot explain that decline unless it can be shown that inefficiency is increasing. The major problem of assessment, however, is the application of inappropriately high standards. Sometimes a set of changes are judged to be of little consequence because their benefits are not equivalent to what a free-market reform would presumably bring; by that

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

standard few organizational changes are likely to be judged significant.

Sometimes a particular measure or set of measures is judged to be of little importance because it will not reverse the growth rate decline; few individual measures are ever likely to have so large an economic effect. The Agency should not reject "second best" solutions in its evaluation procedures. The analysis should be more open to the possibility that a given policy or organizational change may be helpful even if it does not succeed in reversing the growth-rate decline or matching the performance of a competitive market system.

CONFIDENTIAL

CONFIDENTIALSubtopic Evaluations and Recommendations (cont.)III. Energy1. Introduction

Five areas are important for evaluating the Agency's work on Soviet energy: (a) the CIA forecasting record on Soviet energy; (b) the adequacy of CIA analyses of links between energy and the economy; (c) the quality of work on the Soviet energy balance as a whole; (d) communication of research results; and (e) prospects for Soviet energy in the 1980s.

2. Methodology and Findings

The Panel is impressed with the quality and quantity of the effort the CIA has put into its study of Soviet energy over the years, even though they have made mistakes in some of their major forecasts. The fact that others suggested forecasts which will likely turn out closer to what actually transpires is less important than it might seem on first glance, since it is quite possible that those forecasts will be right for the wrong reasons.

Traditionally, Western forecasts of Soviet energy production, when they have been offered, have been heavily influenced by official Soviet plans. The CIA saw earlier than most (in 1977) the error in assuming that Soviet energy output

CONFIDENTIAL

CONFIDENTIAL

71

Subtopic Evaluations and Recommendations (cont.)

plans are so carefully drawn up that they will serve well as projections of what will actually transpire. Now, in the 1980s, the CIA and the rest of us are still trying to figure out how to judge whether, in fact, the plans are accurate.

Why did the original oil estimates for 1985 and 1990 err, and what has the Agency learned from that? There were apparently two major miscalculations involved in the September 1977 estimates: (a) the CIA reserve estimates were too low; and (b) the CIA had not counted sufficiently on Soviet willingness in the middle of the five-year plan to substantially reallocate resources to oil and gas and away from other sectors in order to forestall a decline in energy output.

On reserves, the basic argument was that the CIA had relied primarily on open Soviet literature to guess at the reserve estimates (the actual estimates are a state secret), and that--ironically--some of the literature they used was overly pessimistic about the reserves. They subsequently learned from interviews with well placed emigres that the reserve data on which they put the greatest reliance in the literature was considerably lower than data officially approved by the government commission, which must approve all reserve estimates before exploitation begins. A good guess about the source of the bias is that the low estimates were a symptom of a

CONFIDENTIAL

CONFIDENTIAL

72

Subtopic Evaluations and Recommendations (cont.)

bureaucratic battle for resources, and not an unbiased attempt to get at the truth.

Our general impression concerning the current CIA techniques for forecasting oil output is that they are more sophisticated than they were five years ago, and that the quality of the forecasts is as a result, higher. In correcting its forecasts the CIA has learned--as we all have--that the really interesting issues regarding the energy sector are the interactions between it and the economy as a whole. As the energy sector draws away capital from the remainder of the economy, that affects economic performance; as economic performance improves or deteriorates, that affects the demand for energy.

One of the evident weaknesses in CIA work on Soviet energy has been the disproportionate amount of time spent on oil, to the detriment of work on the other energy carriers and on energy consumption. Efforts devoted to the balance as a whole are roughly as follows:

Energy Supply	(<u>Person-years***</u>)
Oil	10-15* (4-6)**
Gas	1
Coal	less than 1
Energy demand	2

* During the last year and a half when the oil estimate was being revised.

** "normal" level of effort

*** excludes consultants.

CONFIDENTIAL

CONFIDENTIAL

73

Subtopic Evaluations and Recommendations (cont.)

There is now just beginning an NIE on "Soviet Energy Prospects into the 1990s" which will take a comprehensive look at the balance overall. We suspect that this NIE will exert a strong positive influence on SOVA, pushing the energy estimates into the mainstream of current estimates, and--more importantly--nudging SOVA towards a somewhat more even-handed effort to estimate the entire balance.

Further work on the consumption side of the balance is imperative. CIA efforts in this area have traditionally been weak. We need to know much more than we now know about the possibilities for the Soviets to achieve significant gains in energy conservation without major economic reform, and we need informed speculation about how efforts at economic reform might affect energy consumption. Unless equal care is put into the demand and supply sides of the energy balance, the resulting estimate of net energy exports will suffer; estimates of oil, gas, or energy exports for the USSR (or any country) are only as reliable as the least reliable estimate in the balance from which they come.

3. Recommendations

The Panel has several recommendations which it feels would improve further CIA work in this area.

CONFIDENTIAL

CONFIDENTIAL

74

Subtopic Evaluations and Recommendations (cont.)

a. SOVA should reallocate resources devoted to oil into work on the other energy sources and on energy consumption, in the process shifting the focus of their effort from the supply side, and in particular from oil, to the balance as a whole. Our ultimate interest in Soviet energy lies in the prospects for Soviet energy exports, and the implication of these prospects for hard currency earnings. Given that, it is only sensible to forecast the total balance in order to estimate exportable energy, which can then be disaggregated into oil, gas, coal, and primary electricity.

We encourage the Agency to move in that direction, in fact to move far enough so that they do not issue simply an "oil estimate", but rather periodic forecast of the entire balance.

b. We also recommend that the Agency consider devoting somewhat fewer resources to energy as a whole than it does now. The important issue is total economic performance, and the energy sector is only one determinant of that. It is an important determinant, but no more important than agriculture, investment, or changes in economic policy and economic organization. Some reallocation of effort away from energy towards these other issues might prove beneficial to our overall understanding of economic and, indeed, energy prospects for the Soviet economy.

CONFIDENTIAL

CONFIDENTIAL

75

Subtopic Evaluations and Recommendations (cont.)

c. In the work which is done on the energy balance the Agency should focus on technological options open to the Soviets in the 1980s. Prospects for coal, for example, are determined in large measure by Soviet ability to identify and exploit economical ways to treat Kansk-Achinsk coal via, say, liquifaction. Prospects for gas exports, which in view of the "oil and gas glut" now appear fairly limited, could force the Soviets to think about gas derivative products, for example, methanol. Because our basic interest is in hard currency earnings from energy, these possibilities should be carefully explored.

d. The Agency needs to do a great deal more work than heretofore on East European energy balances, and on the ability and willingness of Eastern Europe to absorb increasing quantities of Soviet gas, while oil deliveries possibly fall. No one knows what the actual possibilities are, yet the issue is an important one. It is clear that in the 1980s the Soviet Union will be faced with increasing domestic gas surpluses along-side possible oil shortages. In that situation they will be seeking to export their gas, first to Western Europe, but failing full realization of their goals there, then to Eastern Europe.

CONFIDENTIAL

CONFIDENTIAL

76

Subtopic Evaluations and Recommendations (cont.)IV. Agriculture and Food

The most important roles of the intelligence community in assisting policy makers with respect to Soviet food and agriculture are:

- (a) to provide projections of the performance of agriculture for the short run (annual) and the medium run (one or two plan periods) on the basis of announced plans, policies and resource commitments;
- (b) to provide analyses and projections of the anticipated developments of Soviet agriculture in the international markets for agricultural products;
- (c) to indicate to policymakers the effect of agricultural performance upon the rest of the economic system and to analyze the degree to which shortfalls in agricultural production create significant vulnerabilities;
- (d) to provide the appropriate background and analysis that might indicate whether the current mix of agricultural and food policies will be significantly modified during the 1980s, or whether it's more likely, given the recent efforts at devising a new

CONFIDENTIAL

CONFIDENTIAL

77

Subtopic Evaluations and Recommendations (cont.)

food and agricultural program, that there will be little in the way of reform and reorganization during the 1980s;

- (e) to indicate that if policies are modified, what are the possible features of the economic reforms and administrative changes that might be undertaken.

1. Methodology

a. Measurement of Agricultural Production

Since the 1950's, specialists at CIA have developed and refined the major Western database for evaluating Soviet agricultural production. Details on crop production, livestock herds, animal production and agricultural imports are gathered from Soviet sources, with adjustments necessary as in the corrections for moisture and waste in grain. The methodology used at CIA has been extensively reviewed by the profession and is both respected and used by specialists everywhere. This database was developed to serve two major purposes: (a) to estimate agricultural value-added in the calculation of Soviet GNP; and (b) to provide the structural data necessary to enable analysts to apply quantitative methods in the measurement of productivity and the construction of models for simulation and forecasting purposes.

CONFIDENTIAL

CONFIDENTIAL

78

Subtopic Evaluations and Recommendations (cont.)b. Application of Quantitative Methods

In its quantitative analysis, the CIA has been an important innovator in some areas and a competent follower in others. These methods are used for both short-term forecasting of grain and livestock and for long-run projections of five years to twenty years. Our review suggests that the CIA's application of quantitative methods has been successful because the essential role for analyst judgment has been maintained.

c. Projections

The CIA provides projections of probable outcomes of five-year plans and of particular campaigns, such as the non-black earth area (non-chernozem) program or the industrial livestock complexes. The Agency has utilized a number of methodologies, modified to some degree to meet their special needs, to assist them in their projections. The projections of agricultural output for five-year plan periods and for other periods of several years are based upon the use of a production function approach. Future output levels are dependent upon the changes in the quantities of inputs and in productivity. The coefficients in the production function, which is a Cobb-Douglas function, have been estimated from factor shares. Recent five-year plans provide sufficient data to permit estimates of planned input changes for the major inputs--land,

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

labor, capital, and current purchased inputs. Combined with judgments concerning productivity change, the probable growth of output can be indicated.

2. Findings, Interpretations and Conclusions

Our review of the Agency's major findings on Soviet agriculture indicates that the record is an excellent one.

Any review of the Agency's interpretations of agricultural developments must recognize that agricultural production is subject to the significant influence of exogenous natural factors, such as rainfall, temperatures, diseases, and insect infestations. We do not yet have the ability to predict the course of climatic variables for any extended time period, nor in most cases can disease and insect incidence be predicted. And even where the climatic variables can be observed ex post, as in the United States, our models relating climate and crop production predict output with a significant error. In addition, Soviet crop production is especially vulnerable to weather phenomena that occur with suddenness, such as the hot dry (sukhovy) winds, or rain or snow at the beginning of the harvest in regions with a short growing season. Consequently, while climatic conditions can be favorable for most of the season, sudden adverse events can turn what was a very good crop growth pattern into an unfavorable outcome.

CONFIDENTIAL

CONFIDENTIAL

80

Subtopic Evaluations and Recommendations (cont.)

Due to the climatic conditions affecting agriculture and the agronomic practices followed in the USSR, crop production not only varies significantly from year to year, but there are important differences in crop yields from one period of five years to another that must be attributed to climatic variations. The Agency has devoted considerable resources to the study of both short-term and long-term climatic change. This work resulted in the very important conclusion, which was published in 1976, that a significant part of the agricultural output growth during the decade ending in 1974 was due to favorable climatic conditions. Over half of the increase in grain production realized during 1962-1974 was attributable to climatic change. Based on this analysis the projection of grain production for 1976-80 was very close to actual performance. The most likely projection as made in October 1976 was for an average grain output of 200 million tons per year for 1976-80. The climatic research was the basis of projections in 1979 of grain output for 1985 of 235 million tons, if weather were normal or average, in contrast to the plan objective of 255 million tons. Subsequent use of the analysis resulted in a set of projections for 1981-85 for weather ranging from poor (average of the early 1960s) to good (average of 1970-74) of 183 million to 230 million tons. The plan goal for these years was 239 million tons.

CONFIDENTIAL

CONFIDENTIAL

81

Subtopic Evaluations and Recommendations (cont.)

Little attention was given to projections of meat production prior to 1980. Prior to 1980 meat output was projected on the basis of past trends and consistency with other plan goals, such as grain and feed output. This approach was appropriate when the grain and feed output goals were approximately met but a different approach has been required in recent years. In September 1982 meat output for 1985 was projected on the basis of anticipated levels of grain output of 215 million tons and grain imports of 34.4 million tons. While the plan figure for meat production for 1985 is 18.2 million tons, the estimated output is 16.5 million tons or a shortfall of approximately 10 percent.

One characteristic of Soviet agricultural policy has been its "campaign approach"; this is a strategy in which large amounts of resources are concentrated upon a particular objective. These objectives, at least when announced, are generally over and above what has been included in the plan. We reviewed the Agency's analysis of three such campaigns--the new lands program of the 1950s, the non-chernozem program announced in 1974, and the industrial livestock complexes. With the exception of the new lands program, it is hard to fault the Agency's evaluation of the prospects of programs. The industrial livestock complexes, which are large scale producing units for livestock and poultry, generally in confined facilities, have made a rather modest contribution to

CONFIDENTIAL

CONFIDENTIAL

82

Subtopic Evaluations and Recommendations (cont.)

meat output. The generally negative evaluation of the Agency now appears to have been accepted by Soviet policy makers, since emphasis has now been shifted back to the improvement and modernization of livestock production facilities on the regular farms. The livestock complexes, as a rule, have been established as independent enterprises. As a result of the development of the complexes, feed supplies were diverted from the farms and many farms gave up all or most of their livestock and poultry. This resulted in a waste of labor.

The Russian Republic non-chernozem program was designed to double the output of agriculture in this region of the RSFSR. The program called for a substantial concentration of resources devoted to land improvement, including drainage and irrigation, and increases in purchased inputs, such as lime and fertilizer. The Agency evaluation of the program was a negative one, even though there is general agreement that this region, which was once an exporter of agricultural products to the rest of Russia and to world markets, has significant agricultural potential. The negative evaluation has been justified by performance--agricultural output of the region in 1976-80 failed to increase over that of the previous five year period, while the planned increase in output was more than a third.

CONFIDENTIAL

CONFIDENTIAL

83

Subtopic Evaluations and Recommendations (cont.)

The evaluations of the new lands program, which were done in the mid-1950s, can be criticized on the basis of hindsight, though at the time the projection was made that the net economic benefit of the new lands program would be small seemed reasonable. The original evaluations, though generally correct, can be criticized on two grounds. One is that there was no recognition of the possibility of yield improvement through technological change; the other was that the yield potential of the area under favorable climatic conditions was underestimated. It should be said that both of these limitations of analyses of crop production potentials have now been corrected. In recent efforts the effects of technology and climate are uniformly considered in the projections. It may be noted that it now appears that the failure to consider the possibility of yield improvement due to technological change was an unimportant omission, the substantially higher grain yields during the 1970s in the new lands area than during the 1950s and early 1960s can be attributed primarily to climatic change.

An important variable in the consideration of Soviet agriculture is its role in international trade. In an analysis published in 1979, the Agency projected average grain imports in the 20 to 30 million ton range during 1981-85. It was noted, of course, that the magnitude of the imports would depend upon climatic conditions and Soviet grain production.

CONFIDENTIAL

CONFIDENTIAL

84

Subtopic Evaluations and Recommendations (cont.)

Actual grain imports have been greater than this but Soviet grain production has been below the lowest levels projected by the Agency, even with the assumption of bad weather.

Projections of net trade are subject to substantial error since net trade is a residual derived from the difference between domestic consumption and production; an error of just 5 percent in production could result in an error of as much as 30 percent for imports if imports are one-sixth of production.

During the 1970s there were times when it appeared that port capacity imposed a limit upon the quantity of bulky agricultural imports, such as grains and other feeding materials, that could be imported. We satisfied ourselves that the Agency had adequately anticipated the changes in the capacity of Soviet ports to handle grain.

Another area that has commanded the attention of the Agency has been the frequent policy and administrative changes that have occurred in agriculture over the past three decades. These changes have generally been of three different sorts--changes in incentives (higher output prices, increased wages and pensions), increases in investment and current purchased inputs, and administrative changes. The Agency has found that changes in incentives and increases in inputs committed to agriculture had positive impacts upon agricultural production at least up through 1978. However, the results are

CONFIDENTIAL

CONFIDENTIAL

85

Subtopic Evaluations and Recommendations (cont.)

not always as expected. For example, significant increases in labor income on collective farms after the mid-1960s did not result in either a greater total commitment of members' time nor an improvement in the seasonal distribution of labor available to the collective farms. The Agency has devoted resources to the evaluation of the impacts of increased fertilizer availability upon grain and other crop output and their analysis has been very reasonable.

The Agency undertook an extensive review of the widely heralded Brezhnev Food Program, which was announced in May 1982 after at least two years of preparation. The bottom line in the CIA analysis is the conclusion that the expectations of Soviet officials that the new program would have significant positive effects on production within two or three years were unrealistic and would not be fulfilled. The new program was described as being very unimaginative, primarily consisting of a continuation of past efforts--including another round of output price increases. The unimaginative character of the new program was attributed to an inability at the highest policy level to agree upon more decisive action. The food program included some administrative changes that could easily have negative output effects. New committees were created to provide for coordination of the "agroindustrial complex" at the national, oblast, krai and autonomous republic levels. These coordinating efforts could add to more confusion and

CONFIDENTIAL

CONFIDENTIALSubtopic Evaluations and Recommendations (cont.)

indecisiveness. A new set of institutions were to be created at the rayon level--rayon agroindustrial associations (RAPO). The RAPOs are to coordinate all agricultural activities at the local level; it is not clear how the activities of the RAPOs will be coordinated with the functions carried out by the ministries. The Agency has followed the subsequent reactions of numerous Soviet officials and scholars to the food program, including the RAPO innovation.

An important policy that has been maintained for the past two decades has been that of stable prices for major food products, such as meat, dairy products and flour and bread, sold in the state stores. However, in the effort to expand the output of farm products, prices paid to farms have increased significantly over the years. Consumers now pay less than half the cost of bringing meat to the retail store and the total subsidies to agriculture, including some 5 billion rubles on industrial products sold to agriculture, approach 58 billion rubles in 1983. The low food prices have resulted in a substantial excess of demand over supply, resulting in long queues, bare shelves, and various forms of rationing of scarce supplies.

One important issue is whether the cost of food and agricultural subsidies constitutes such a burden on the financial system and the economy as to require the policy of

CONFIDENTIAL

CONFIDENTIAL

87

Subtopic Evaluations and Recommendations (cont.)

stable retail prices to be abandoned. The Agency believes the subsidies, which now account for about 16 percent of the total budget, can be maintained into the indefinite future without undue strain upon the financial system. This is an important conclusion and tends to support the view that the present food and agricultural situation is a tolerable one and one that does not demand radical change. This conclusion does not mean that change will not occur, but it does mean that even if the change or changes have little positive effect upon output that there will be time for further efforts to improve the situation.

3. Clarity of Presenting Findings

Because of the complexities of the factors that affect outcomes in agriculture, the clarity of findings may well be perceived differently by those who have familiarity with agriculture and by those who do not have such familiarity. However, our review of a number of findings indicates that the findings are stated with adequate clarity, though some readers may have difficulty in fully understanding the process by which the findings were derived.

CONFIDENTIAL

CONFIDENTIAL

88

Subtopic Evaluations and Recommendations (cont.)V. Foreign Economic Relations1. Introduction

In the assessment of Soviet foreign economic relations, one is ultimately concerned with the contribution of such relations to Soviet capabilities to project military and economic power. In this area, the panel was concerned with the following broad areas:

- (a) the conceptual framework;
- (b) specific choice of methodology;
- (c) treatment of behavioral issues; and
- (d) the precision and balance of CIA communication.

2. The Global Context of Soviet Trade and Finance

Since the late 1970s, the CIA has recognized the growing importance of world trade and international finance and has sought to increase its expertise and contacts in those areas. One consequence of this shift in attention has been a transfer of resources--particularly skilled analysts--away from the Soviet trade and financial area. Certainly, the CIA's gain in understanding global markets has contributed to a more realistic appraisal of Soviet participation in such markets. For example, two studies published in 1981 provided an

CONFIDENTIAL

CONFIDENTIAL

89

Subtopic Evaluations and Recommendations (cont.)

excellent assessment of Soviet participation in world markets for non-fuel minerals and metals.

Unfortunately, however, the establishment of broad competence on such issues as East-West trade, LDC debt, and technology transfer has often been at the expense of specific research on Soviet trade and debt. Over the past three years, the Soviet trade branch operated with only three full-time analysts, none of whom had been in the branch before 1979. Problems also arise because responsibility for some components of the Soviet balance of payments remain outside SOVA itself, e.g., agricultural trade and arms sales in OGI.

3. The Conceptual Framework of Analysis

Soviet comparative advantage and gains from trade seem to be the most useful foundation on which to construct an accurate model of Soviet foreign trade decision-making. True, the gains from trade and comparative advantage considerations do not play the same role in Soviet central planning as they do in Western economies. Nevertheless, it is apparent from Soviet foreign trade decisions observed in the past that trade flows do adjust in ways which suggest an underlying mechanism operating to weigh the costs and benefits of various policy alternatives in the foreign sector. Consequently, the terms of trade and appropriate valuation should be of concern to Western analysis,

CONFIDENTIAL

CONFIDENTIAL

90

Subtopic Evaluations and Recommendations (cont.)

not only for hard currency trade but for Soviet trade with client states and other socialist countries.

Unfortunately, Soviet foreign trade has been evaluated by the CIA largely in terms of "import requirements" and "export availability." CIA reports on Soviet foreign trade activity seldom consider important aspects of behavior--responsiveness to price, domestic allocation to export sectors and import substitution, or reaction to aggregate budget constraints. In this important area, CIA analysts have chosen not to apply the conceptual models developed by academic specialists to evaluate foreign trade under central planning.

4. Specific Methodologies

Trade estimation includes analysis of both official trade statistics and mirror statistics, with attention given to commodity composition and prices within various regional categories. Considerable attention was given to the reconciliation of foreign trade statistics (Soviet-West) during the 1970s. This was a major contribution, but a comparable effort was not made for intra-CMEA trade, and additional work on Soviet-LDC trade has only recently begun.

Issues of appropriate pricing in foreign trade have become critical because of the wide swings in relative prices.

CONFIDENTIAL

CONFIDENTIAL

91

Subtopic Evaluations and Recommendations (cont.)

Additional expertise on intra-CMEA trade and pricing exists in the East European group, but the CMEA perspective is still weak in SOVA analysis of Soviet foreign trade. Eastern Europe is still evaluated more as a fixed liability for the Soviet economy rather than as a varying balance of liabilities and assets.

The linkage of trade flows to domestic and foreign activities is crucial for the projection of Soviet trade. In the construction of SOVSIM, few aspects of Soviet foreign trade were modeled explicitly in a behavioral sense. Energy exports were determined by availability, grain imports by domestic requirements, and machinery imports by a financing limitation. Imported capital measures appear for the machine-building, chemicals and petroleum branches, but have no differential productivity effect on production. Total machinery imports do impact domestic capital investment.

Another category of analysis involves financial issues, the intertemporal management of balances on goods and services. The CIA was a leader in the estimation of the Soviet balance of payments and its estimates remain widely used and respected among specialists. The principal problem with those estimates has been the large residual between financing activity and current account balances. SOVA now believes that Soviet net lending of hard currency to certain client states--Cuba and

CONFIDENTIAL

CONFIDENTIAL

92

Subtopic Evaluations and Recommendations (cont.)

Vietnam--and export credits to developing countries are probably the largest components of the "errors and omissions" residual.

There remains an inconsistency in CIA's position concerning the contribution of Western machinery to Soviet economic growth. Imported machinery (from the West or Eastern Europe) is not granted a differential impact on Soviet capital productivity in SOVSIM and seldom considered as a major factor in Soviet growth prospects for the 1980s. However, earlier microeconomic studies by CIA suggest that Western machinery has been very important in the growth of certain branches such as petroleum, chemicals, and vehicles.

Another significant area concerns the strategic non-economic dimensions of Soviet economic relations with the outside. Soviet activities in commerce and finance serve a variety of intelligence and military objectives beyond purely economic advantage. Several studies by CIA analysts have made significant contributions to Western understanding of such Soviet activities in banking, shipping, fishing and other commercial transactions.

CONFIDENTIAL

CONFIDENTIAL

93

Subtopic Evaluations and Recommendations (cont.)5. Analysis of Soviet Behavior and Foreign Trade Forecasts

Estimation of historical flows and stocks provides a valuable database, but forecasts based on such data require judgments concerning Soviet objectives in foreign economic relations and the resulting behavioral patterns, both short-run and long-term. Among the most misleading of exercises is mechanical extrapolation, and recent CIA assessments of Soviet hard-currency constraints in the 1980s (using SOVSIM and the BOP accounting model) appear to be more of this character than careful judgments of likely Soviet behavior.

In the last five years, CIA has sought to avoid forecasting Soviet trade and debt. Instead, they have preferred to provide multiple scenarios and qualitative statements about future conditions, e.g., a hard currency "bind" in the 1980s. In their quantitative analysis of Soviet growth prospects, the foreign sector has been determined largely by judgments about domestic conditions. The most critical example was the energy estimate of declining oil production which, under the assumptions made, indicated a major Soviet shortage of hard currency in the early 1980s.

CONFIDENTIAL

CONFIDENTIAL

94

Subtopic Evaluations and Recommendations (cont.)6. Intelligence Crucial for U.S. Policy on East-West
Economic Relations, 1980-1982

East-West economic relations have become a significant issue for US foreign policy. Therefore, intelligence that dealt specifically with such issues as sanctions, denial, dependency and vulnerability since 1979 were of particular interest to the Panel. We have found in a number of recent CIA reports a tendency to overstate the vulnerability of the USSR to external economic pressure. One notable--and extremely important--exception to this has been the CIA reports on the Siberia-to-Western Europe natural gas pipeline. CIA issued several reports which accurately emphasized Soviet commitment and ability to complete the line essentially on time.

One month after the Soviet invasion of Afghanistan, a study entitled the "Impact of Economic Denial Measures on the USSR" (ER80-10037, January 1980) was submitted by CIA. Although this assessment quite properly emphasized the importance of all Western countries' cooperation for a successful embargo on credits and manufactured goods exports to the Soviet Union, there were several important points where the analysis was faulty and misleading in tone. Even as oil prices were rising sharply it was asserted that Soviet hard currency earnings were expected "to fall drastically as Soviet oil exports decline." The US partial grain embargo was judged to be "tantamount to a

CONFIDENTIAL

CONFIDENTIAL

95

Subtopic Evaluations and Recommendations (cont.)

total embargo" since alternative supplies were unavailable that season, and the shortage of feed was expected to reduce meat production by 1 to 1-1/2 million metric tons in 1980. In fact, oil revenues continued to grow in 1981-82, the USSR was able to import grain in the volume desired (although composition and cost were less favorable), and meat production was maintained at around 15 million tons. It was further asserted that the impact on Soviet consumer programs would be "marked," and that there would be a "psychological blow to the Soviet population when it learns of the embargo from the VOA, BBC, and the Munich radios."

One year later a more accurate and balanced assessment was submitted ("USSR: Impact of Economic Denial Measures," ER81-10021, January 1981). Here, it was acknowledged that the impact of US measures on the USSR had been negligible in 1980 and would wane further in 1981. This study also identified specific industrial sectors which might be vulnerable to Western sanctions.

The meanings of such terms as "leverage" and "vulnerability" were never precisely defined in the studies which we have reviewed. In foreign policy terms, "economic vulnerability" involves at least three important aspects--reliance, substitution costs, and instrumentality. In many areas of industrial technology, the USSR had chosen to rely

CONFIDENTIAL

CONFIDENTIAL

96

Subtopic Evaluations and Recommendations (cont.)

extensively on Western suppliers. That was usually what was documented in CIA studies. Should supplies be denied, what would be the consequences of substitution in higher costs for any given performance level and the delays associated with disruption and alternative contracting? These questions were much more difficult than the estimation of reliance itself, and appropriate efforts to answer them and provide those answers to policymakers were not always made. Finally, "instrumentality" involves the feasibility of imposing sanctions on trade--an estimation of economic costs imposed on Western interests and the political costs involved in multilateral policymaking.

The imposition of martial law in Poland in December 1981 led to another round of US sanctions against Poland and the USSR. A new assessment of "Soviet Economic Dependence on the West" (SOV 82-10012, January 1982) reviewed the growing Soviet dependence on Western machinery, technology and food during the 1970s. It asserted that hard currency imports would "be more crucial in the 1980s than before." A new projection of the Soviet balance of payments suggested a "hard currency bind with no relief in sight," which would lead to reductions in Soviet trade with the West. This would cause disruption in key sectors of the Soviet economy and--given its limited capacity to adjust--would entail significant losses for the Soviet economy.

CONFIDENTIAL

CONFIDENTIAL

97

Subtopic Evaluations and Recommendations (cont.)

Three months later, "The Soviet Bloc Financial Problem as a Source of Western Influence" (NIC M82-10004, April 1982) was more ambivalent on Western leverage and policy implications. It asserted that this was an "unusual opportunity to influence Soviet Bloc developments, although there exists little direct leverage on these countries' policies." While it was recognized that "Soviet reaction might be aggressive or accomodating" to the exercise of Western leverage, it concluded that pressure might well limit Soviet non-core activities in the Third World that had high hard currency costs.

In May, SOVA's assessment became very supportive of "resource denial strategies" just before the attempt to impose sanctions on West European firms transferring US technology to support the Soviet pipeline. It argued that a Western policy restricting credits to the Soviet Union would play an important role in avoiding "overexposure by private banks and costly claims on Western budgets," and would also "put pressure on Soviet authorities to re-examine priorities." "Even modest declines in imports" could greatly complicate Soviet problems and make allocational decisions more painful. The ultimate payoff for the West would be a squeeze on Soviet military and foreign policy programs during the 1980s, weakening capacity to project power in the Third World, and perhaps influencing evolution of the regime toward a less aggressive posture.

CONFIDENTIAL

CONFIDENTIAL

98

Subtopic Evaluations and Recommendations (cont.)

Although the reports discussed above tended to overstate Soviet vulnerability to economic pressure, their effect is counterbalanced somewhat by the analysis provided by SOVA of sanctions relating to the Siberia-to-Western Europe natural gas pipeline. Throughout 1982--when the US was pursuing efforts to stop, or at least delay, the pipeline--SOVA consistently emphasized that Soviet leaders had both the will and capability to finish the line essentially on schedule, and to meet commitments for new gas deliveries, (see especially SOV 82-10023X, February 1982; and SOV 82-10120, August 1982). On this very important issue the CIA provided US policymakers with well-founded analysis concerning the limited impact which US economic sanctions could have on the Soviet gas industry.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)VI. The Soviet Burden of Empire1. Introduction

The Panel identified a set of issues in the category "burden of empire" that it felt may possibly bear on assessments of Soviet economic performance. They are: (a) Soviet economic relations with the CMEA countries of East Europe (Poland, GDR, Czechoslovakia, Hungary, Romania, and Bulgaria) and the subsidized character of those relations; (b) Soviet economic and military aid to communist and non-communist LDCs; and (c) the unevenness or variations of economic life and development among the USSR's regions and republics.

A number of definitional problems arise which, once mentioned, may be set aside. Given that the purpose of the entire Soviet power establishment, including the armed forces and the security police, is to protect and to expand its control, even at the cost of efficient, productive economic life, the economic burden of empire is pervasive and unquantifiable. In one sense, such expenditures are cost-effective to Soviet rulers because they produce the satisfactions of empire. In another sense, the sacrifices of resources and economic rationality made in the name of political control may become so great or unleash such social

CONFIDENTIAL

CONFIDENTIAL

100

Subtopic Evaluations and Recommendations (cont.)

forces as to threaten control itself, as we have witnessed in Poland.

We are mindful that much of the Agency's analysis of Soviet economic dealings with Eastern Europe and with LDCs has purposes other than measuring their impact on Soviet economic performance. Analysis in these areas offers important insights into the economic prospects of the East European countries and other Soviet clients, and, hence, contributes to warning of problems that may become political and international crises. Trends in Soviet aid to communist and non-communist LDCs illuminate Soviet foreign policy and strategic priorities.

2. Major Conclusions

The Agency does a substantial amount of analysis on Soviet economic relations with Eastern Europe and on economic-military aid to LDCS on a continuing, routine basis, as well as to support specific regional or country contingency analysis. The routine reporting appears in only a limited number of topical or serial products (e.g., JEC or State Department issuances), somewhat disguising the total effort underlying it. By contrast, there is apparently very little analysis done on the economies of Soviet regions/republics as such, largely because of limited personnel.

CONFIDENTIAL

CONFIDENTIAL

101

Subtopic Evaluations and Recommendations (cont.)

The Agency has made estimates of the dollar value of Soviet subsidies and aid to its East European, other communist, and non-communist clients; in other words, estimates of the external burden of empire. There are admitted methodological problems (such as valuation of Soviet imports/exports in trade with Eastern Europe) and personnel constraints that have limited the depth of analysis in these areas (although personnel resources are increasing).

We have found no evidence or inferential basis for concluding that: (a) the economic impact, of Soviet imperial dealings with this set of external entities, on Soviet economic performance, is so great that it overwhelms political considerations; or (b) that the Agency's estimates of the magnitudes and trends of these burdens is likely to be seriously in error. Thus, if Soviet political leaders decided that they should be more generous with various clients (e.g., Poland) for their own political reasons, they could do so on economic grounds.

At the same time there is reason for concern about the adequacy of analysis of Soviet economic relations with client states with regard to the character and extent of subsidies in trade with Eastern Europe. Data and methodological problems along with the relatively low volume of work in this area, leave open some possibility that phenomena are occurring of

CONFIDENTIAL

CONFIDENTIAL

102

Subtopic Evaluations and Recommendations (cont.)

greater importance to the Soviet economy than we realize (their importance to East European economies is much more obvious). The fact is, for example, that the Soviets are striving to be less generous toward their East European dependencies currently, despite contrary political pressures.

Agency analysis of Soviet relations with Eastern Europe displays a paradoxical situation, the understanding and observation of which is clearly very important. Patterns of trade between the USSR and the East European states lead to charges of exploitation from both sides. The Soviets sell basic resources at subsidized prices, sacrificing potential hard currency earnings. In return, they get finished goods of less than world standards, but better than their own, and, of course, strong political influence. More or less, for better or worse, Soviet and East European decisionmakers have accepted a closed system of backwardness that helps preserve political arrangements within and among them, at the cost of economic performance. The USSR has avenues to the outside by virtue of size; Hungary has them to a degree by virtue of political license. On the whole, the system is muddling down, not through, most catastrophically in the case of Poland.

The key question that economic analysis helps to illuminate is basically a political one: does the system work sufficiently to keep political controls intact? One

CONFIDENTIAL

CONFIDENTIAL

103

Subtopic Evaluations and Recommendations (cont.)

comprehensive report done for the Agency's Office of European Analysis concludes that, on the whole, it does not. Because of declining growth rates (negative growth in some cases), rising expectations, Western influences, and resentments all around, current Soviet means of managing Eastern Europe are becoming less and less tenable, according to this analysis. Either the Soviets must increase their economic largess, give the East European countries more license for reform and Western trade (to which local leaders may or may not be able to respond), or move in the direction, perhaps with military action, of more Stalinist measures. Something has to give.

The Panel reaches an ambivalent judgment on the adequacy of Agency analysis in this clearly important area. A good deal of analysis is done. Resources are being added. The importance of the area is recognized. However, it remains of secondary priority except where crisis demands attention (Poland). Personnel needs are magnified by the diversity of countries (e.g., language requirements). The location of East European and Soviet analysis in separate offices creates special interface problems which require an enduring remedy. A more general but important concern is that overall work on the Soviet economy appears insufficiently attentive to the "CMEA dimension," that is, to the fact that trade with Eastern Europe is the largest portion of Soviet foreign trade. It, therefore, remains an open question whether the level of attention to

CONFIDENTIAL

CONFIDENTIAL

104

Subtopic Evaluations and Recommendations (cont.)

Soviet-East European economic relations at the Agency is commensurate with its significance for US national security policy.

The Panel believes that the Agency's very limited attention to the economies of the USSR republics and regions could profitably be increased somewhat, for three reasons: (a) as the Agency's analysts recognize, a fundamental aspect of the problem of Soviet economic growth is regional in character: the capital is in the northwest region, the labor in the south and southeast, and the natural resources in the northeast; (b) as centralized as it is, the decisionmaking system of the USSR has a republic-based substructure whose interests influence policy to some extent; and (c) economic diversity among Soviet regions and republics is such as to make its illumination of some importance to non-specialists among the Agency's consumers in understanding the strengths and weaknesses of the Soviet economy. It would seem that for us to understand the Soviet economy, and also to understand how Soviet leaders understand it, more effort and resources on the study of Soviet Republics and regions would be warranted.

CONFIDENTIAL

CONFIDENTIAL

105

Subtopic Evaluations and Recommendations (cont.)

VII. Quality of Life, Morale, and the Second Economy

1. Introduction

The quality of life has received low priority in CIA's work on the Soviet economy. Evidence of this is found in the fact that only two major studies in this area were provided for the Panel's review.

There are three important reasons why the Agency should study the quality of life. First, such knowledge is useful in understanding the political choices that Soviet leaders have to make. Second, the capacity of the Agency to forecast economic and political events will be enhanced by its ability to monitor changes in quality of life. Third, apart from forecasting, the analysis of economic policy requires attention to a variety of quality of life data.

Recognizing that for these reasons the Agency should conduct a program of research on quality of life, a note of caution is in order. These things are terribly difficult to pin down. There is no strong body of social theory to support judgments of cause and effect, and quantitative relationships rarely can be established. In view of such limitations it is important not to promise too much or to overstate the

CONFIDENTIAL

CONFIDENTIAL

106

Subtopic Evaluations and Recommendations (cont.)

confidence with which the causes and consequences of quality of life changes are reported.

2. Methodology

In assessing the methodologies employed by the Agency in reaching conclusions about the quality of life and its impact, it is important to distinguish between the methodologies utilized to measure the "objective" components of the standard of living and the much more "subjective" process of drawing inferences about the significance and consequences implied by the "objective" data. In the studies read, a number of aspects of the quality of life are examined. Often different methodologies are employed in the analysis of each issue. The issues addressed include: consumption levels, health care, criminal corruption, alcoholism, ethnic discontent, and political, cultural, and religious dissent.

The kinds of evidence cited in the reports can provide some insight into the underlying methodologies. In general, the processes of arriving at conclusions about the "objective" indicators of quality of life appear to meet academic standards. That is, to the extent possible, statistics are systematically gathered, evaluated, and compared with figures for Western countries. The work of Schroeder on consumption is a particularly good example here. Data on health care is more

CONFIDENTIAL

CONFIDENTIAL

107

Subtopic Evaluations and Recommendations (cont.)

sketchy. Heavy reliance is placed by the analysts on certain demographic statistics related to health developed by the Commerce Department on the basis of Soviet data.

While the evidence for a leveling off in the Soviet standard of living is apparently quite good, and while conclusions about widespread social ills are based upon a careful reading of admittedly less-than-ideal evidence, by and large, the methodologies employed in examining the "objective" components of quality of life are at least as adequate as those found in the best academic research. Given what appear to be generally acceptable, if not fully satisfactory, methods of the profession in measuring some aspects of social reality, the key problem becomes the methods by which inferences are drawn from these measures.

The essential problem in this regard is that the state of the art does not provide us with a way of knowing what the relationship really is between consumer welfare and social well-being on the one hand, and either regime legitimacy or labor productivity on the other. The evidence upon which CIA analysts base their conclusions consists primarily of statements by Soviet political leaders which posit such relationships, and other evidence which seems to suggest that the leaders take such relationships seriously.

CONFIDENTIAL

CONFIDENTIAL

108

Subtopic Evaluations and Recommendations (cont.)

Another problem in CIA's analysis of the quality of life and morale is the frequent lack of historical perspective. Discontent has been common in Soviet history, and virtually every Soviet regime has berated the young generation for not understanding and accepting regime values more fully. Yet, the Soviet government has up until now proven itself fully capable of managing its own survival in the face of low living standards, mass discontent, and cynicism among the young. Of course, it is true that Soviet society is entering a period of relative austerity after a prolonged period of improving welfare. But, given the considerable capacity of the Soviet people to endure suffering, and the demonstrated capacity of the regime to maintain control in the face of apathy and discontent, it would seem prudent for intelligence analysts to be cautious in any estimates of the consequences of presently observable problems. It would appear that the CIA analysts who participated in writing the most recent study of quality of life were not only aware of these analytic problems, but made conscious efforts to address some of them.

The Panel recommends that CIA devote resources to the development of an analytical framework for handling quality of life issues. It should also develop a formal program for tracking Soviet society by means of social indicators. This would have several advantages: (a) it may provide for some useful comparability between the USSR and other countries, in

CONFIDENTIAL

CONFIDENTIAL

109

Subtopic Evaluations and Recommendations (cont.)

the absence of which the USSR alone may look particularly bad or particularly good in various respects; (b) it would enable the analyst to evaluate Soviet quality of life in terms of time trends, which would provide a clearly useful additional dimension for evaluation; and (c) a systematic array of social indicators may provide a more balanced assessment of quality of life: things that may be improving (perhaps housing and education) would be juxtaposed against the things that are deteriorating, in the absence of such juxtaposition CIA analysts tend to focus on the negative.

3. Interpretations

The Agency's principal conclusion is that the quality of life has been deteriorating. That fact is seen both as a consequence (in part) of the decline in the rate of economic growth to very low levels, and at the same time as a cause of that decline. The major link in the chain of causation is the set of relations between consumption and labor effort: declining growth of output leads to declining growth of consumption which leads to declining effort which leads to declining growth of output. Yet, this causal chain is not clearly analyzed.

Given the importance of this issue, we recommend that the Agency make an explicit study of the relationships between (a)

CONFIDENTIAL

CONFIDENTIAL

110

Subtopic Evaluations and Recommendations (cont.)

levels and rates of change in consumption and productivity; (b) levels and rates of change in consumption and regime legitimacy; and (c) other indicators of quality of life and productivity and legitimacy. On the basis of such studies, the Agency would be able to adopt a more consistent position in its interpretation and avoid simplistic assumptions that bad economic developments always lead to bad social and political consequences.

4. Communication of Results

Four issues are noted here: (a) the language in which the evidence of the declining quality of life is reported; (b) the reporting of the strengths as well as the weaknesses of the system; (c) the consumption-incentive relation; and (d) the reliability of the results as communicated to readers.

First, our impression is that the darker sides of Soviet life tend to be reported in terms that are vivid, racy and emotive. This seems an inappropriate style for an intelligence agency. Dispassionate, cool appraisal should replace breezy language and rich metaphor.

In an effort to understand the sources of the tendency to relatively loose, breezy language, the subcommittee raised this issue with Agency analysts. They acknowledged that the racy

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

and breezy tended to predominate in much of their writing. It was the their view, however, that the reasons for this were to be found in the incentive structure within which they operate rather than in a lack of discipline or professionalism on their part. In their view, the pressures for colorful language arise from a system in which rewards are based upon attracting the attention of significant policymakers. Dull, overly objective writing is seen as one certain way never to attract, let alone hold, the attention of busy executives. While key staff people are the main audience for the substantive parts of reports, even here, it is believed by analysts, a light breezy style is valued. These beliefs are reinforced by an evaluation system within the CIA which places considerable weight on evidence of attention to products by key Executive Branch officials.

Within the CIA, the subcommittee was told, there are periodic shifts in policy regarding the desirability of caveats, explanatory footnotes, and other cautionary, but often uninteresting elements in Agency reports. The current posture seems to be that footnotes are undesirable, that crisp, interesting, appealing prose is appropriate and will be rewarded. These policies are reportedly "enforced" through the four-tier internal review process for CIA manuscripts.

The subcommittee is not fully convinced, although doubtless the analysts reported accurately, that this is a sufficient

CONFIDENTIAL

CONFIDENTIAL

112

Subtopic Evaluations and Recommendations (cont.)

explanation. These same policies were in effect over the past year or more, yet, within this period, there is considerable variation in the degree of caution and balance evident in CIA reports.

Second, CIA reports tend to concentrate on the darker side of Soviet life. People who are familiar with Soviet society understand that there is another side, that there are strengths as well as weaknesses. But not all the policymakers who rely on the Agency reports have this background. Reading about the problems of malaise, nationality tensions, food shortages and so on, they are not in a position to make the necessary mental correction in order to place these things in perspective. If they were reading about such US problems as unemployment, racial tensions, poverty, declining educational attainment, they would understand the broader social and historical context sufficiently to place such dark facts about the US quality of life in a proper perspective. Lacking a knowledge of the corresponding Soviet context, they are likely to emerge with an exaggerated impression about the weaknesses of Soviet society relative to its strengths. It is, therefore, important that the Agency call those strengths to the attention of the readers of its reports.

Third, a distinction should be drawn between the effect on incentives of (a) monetary disequilibrium, or repressed

CONFIDENTIAL

CONFIDENTIAL

113

Subtopic Evaluations and Recommendations (cont.)

inflation, and (b) consumption growth. To the extent that the former is the source of the sentiment that "there is nothing to buy anyway," a strong case can be made for a possible erosion of work incentives; the money wage begins to serve less and less as an inducement to work. The remedy in that case might be a monetary reform to restore macro equilibrium, though this would present significant political difficulties.

Fourth, quality of life is expressed in two kinds of terms: observable indicators like death rates, alcoholism and corruption; and subjective states, like the mood of the population, malaise, shrinking patience, and so forth. The Agency reports tend to make assertions about the subjective states as if they were of the same order of reliability as the observable indicators. While such assertions about psychological states are sometimes based on actual evidence, such as reports of conversations and Znania lectures etc., for the most part they are simply common sense extrapolations from other evidence: if meat supplies are lower this year than last, consumer patience must obviously be shrinking. The Agency should take a much tougher stance with regard to such reporting. It should clearly distinguish what it knows from what the implications may possibly be.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

5. The Second Economy

There are two areas in which the quality of life and the second economy overlap: (a) to the extent that the second economy fosters political and moral corruption, it is an aspect of quality of life; and (b) to the extent that the second economy affects consumption levels, it affects the quality of life.

For both of these reasons, the subcommittee recommends that the CIA increase its effort to develop systematic data on the second economy. Agency reporting on the second economy should be done within a comparative context. It is known from the experience of many countries that illegal business behavior can be fairly extensive, and therefore undoubtedly corrupting, without being of momentous consequence for the society, and without counting very much in our assessment of the society and of the choices facing their leadership.

It would also be useful to distinguish carefully between the legal and illegal components of the second economy. It is true that the two are interconnected in that theft of state property supports much of the legal second economy. Nevertheless, insofar as corruption and illegality are concerned (as parts of quality of life), it is important to

CONFIDENTIAL

CONFIDENTIAL

115

Subtopic Evaluations and Recommendations (cont.)

distinguish the perfectly normal household plot and related activities, from the running of an illegal factory.

With respect to the effect of the second economy on consumption, two points should be made:

(a) By increasing the supply of consumer goods and services, the second economy performs a number of very useful functions for the leadership: in particular, reducing the negative effects of the declining growth rates of state-supplied consumption.

(b) The second economy redistributes income among households, classes (particularly rural and urban), and ethnic groups.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

VIII. The Effects of Slow Growth on System Stress, National Security

1. System Stress

"System stress" is a nebulous concept. We are primarily concerned with forces that may affect internal political stability or that may carry the potential for altering the Soviet political system's essential character. The first question that naturally arises to social scientists reviewing a complex area of investigation is whether there exists a body of theory that may be applied to the particular case. It should then be possible to formulate a model, however crude, of the phenomenon to be investigated and to construct a set of questions to guide the investigation. On that basis a methodology would be developed for collecting data and evidence in analytically relevant categories.

While we have not pursued the investigation extensively, it does not appear to us that the economics literature provides an analytical model or body of theory to serve as a guideline for research in this subject area. Sociology and political science provide various theories of social-political change and conflict which may furnish many useful particular insights. However, it is clear that a conceptual framework for our subject is not to be found on the shelf of any of the standard

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

disciplines. As a consequence, the CIA analyses we have seen exhibit a tendency to "ad hocism." There are references to social unrest, popular alientation, worker demoralization, food riots, rising crime rates and other indicators but these phenomena have not been linked in a coherent analysis.

It is only in recent years that much attention has been paid to the topic of system stress in the intelligence community. To some extent, this may be explained by the fact that the sharp downturn in growth rates, as opposed to the gradual postwar deceleration, dates only from the late 1970s. However, many of the phenomena being reported were visible earlier, as we are now becoming aware. The subject is still conspicuous by its absence also in the unclassified studies published in the JEC reports, except for passing mention in articles devoted largely to other issues. It is not clear to us how the current appreciation of the importance of the subject is embodied in the Agency's program and resource planning.

We detected differences in evaluative nuance among the CIA reports we read. In some the tone seems to suggest actual danger of radical system change--if not tomorrow, then perhaps the day after. In others, the reader may infer that the outcome is not nearly so threatening for the regime (witness, for example, the Rowen 1982 report).

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

From reading the CIA pieces it is never clear just who constitutes "the leadership" that shows concern about slow growth and system stress from time to time, nor which are the most important institutions/analytical centers preparing estimates and data for the elite. Further, we do not gain a very clear understanding of whether the Soviets themselves have valid information on which to base their own analysis.

We believe there is no more important task for the CIA with respect to the issue of system stress than to develop a conceptual framework and corresponding methodology of measurement. It is unlikely that it will prove possible to quantify the various dimensions of the problem and aggregate them with one common metric. Nevertheless, it would be useful to attempt to define discrete states of the different variables and as a first order generalization to frame conclusions about the effects of growth retardation in terms of the range of such state indications. This might provide an effective vehicle for communicating conclusions to policymakers.

System stress is a subject cutting across discipline lines. However, some of the required disciplines for this analysis, such as sociology or social psychology, are not adequately represented in SOVA at present. Every effort should be made to broaden the recruiting base of disciplines.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

In addition, there is still considerable scope for improving interdisciplinary sensitivity of analysts, although the regional reorganization of the CIA has brought a significant improvement in this regard. It would be desirable to press further for forms of research organization and management that would make economic analyses more sensitive to socio-political ramifications, and political-military analyses more cognizant of the social and economic dimensions of the problems treated.

More attention needs to be paid also to the possible regional and ethnic-national impacts of economic decline. Regional analysis is one of the weak points of SOVA's research in a number of subjects.

2. National Security Impact of Slow Growth

This subtopic concerns the effects of sharp decline in the rate of economic growth on the Kremlin's resource allocation priorities and the manner in which the USSR's ability to conduct foreign policies will be impaired or constrained. We focus on the trade-offs between defense and other sectors of the economy and on the foreign policy ramifications of slow growth. Particular questions regarding defense production or organizational changes are not addressed.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

The CIA has clearly indicated that the USSR faces a resource allocation dilemma in this decade and that critical choices will have to be made. A casual reader of the estimates would be made aware of the resource dilemma facing the leadership. He would also be made aware that the regime recognizes the existence of the problem. It is not so apparent whether the regime's appreciation of the severity of the problem matches that of Western observers and this issue is not always clearly focused in the estimates.

The CIA has also clearly concluded that a reduction in the rate of growth of defense expenditures would not result in appreciable improvements in GNP; that is, it would take a sizable reduction in absolute spending in order for the USSR to achieve a surge in GNP. However, somewhat greater improvement in consumption could be gained from slowing the rate of growth of defense expenditures.

These conclusions are clear to a reader who is very familiar with all of the documents available; they are less apparent to a casual reader scanning the key judgments. The CIA needs to do more to highlight these findings that have such direct relevance for policymakers.

The Agency has dealt with these problems on a continuous basis and early on called to our attention the approaching

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

dilemmas. Discussions of these questions were generally couched in very conditional terms. The possible force changes that might result from a decision to cut back the growth of military expenditures have been examined. The Agency also considered the production trade-offs that might be most easily effected if such a decision should be taken. However, CIA did not specifically forecast that resource reallocations would be made nor did it predict the structure of these reallocations, if they were ordered. Given the evidence available to the intelligence community, predictions of investment shifts or defense program modifications would have been purely speculative and could have misled policymakers.

Still, the majority of the estimates we saw gave the reader the impression that, despite the magnitude of the economic problems, the Soviets would most likely continue their traditional 4-5 percent annual increment to the defense sectors. While this judgment was buttressed with some hard evidence, it turned out to be flawed, at least for the most recent past. The explanation for the recent change, however, is still in dispute.

Was the Agency on the look-out for changes? We must reemphasize the difficulty in predicting changes in the Soviet resource allocation scheme. We have little reliable evidence, it appears, regarding the manner in which these decisions are

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

made (e.g., how Gosplan "works these issues," what goes before the Defense Council, who exactly is on the Council, how these trade-offs would be affected by the coming succession struggle). We know even less regarding the mind-set of the responsible people who adjudicate the debate over reallocations and cannot fully identify the spokesmen (or the extent of their influence) for a diversion of resources into consumption or investment. The Agency, in contrast to many outside observers, has been properly cautious in rendering its judgments.

A larger question, however, given this evidence problem is whether or not the CIA made a concerted effort to establish a systematic methodology for identifying the indicators that would give warning of impending or on-going resource allocation shifts. As noted in the critique of the Agency's work on system stress, there does not seem to be a clear collection plan in the work we have reviewed, designed to bring attention to preliminary indicators of policy change.

The CIA has done substantial work on the national security trade-offs that might be impelled by economic growth rate declines and certain other economic shortcomings. However, there appears to be no single document that addresses the range of possible effects of the economic slowdown--i.e., on military expenditure, force structure, arms control policy, foreign policy. The Panel urges that such a document be prepared.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

IX. Soviet Leadership Perceptions

1. Introduction

Accurate perceptions of how the Soviet leadership views the Soviet economy and its basic trends are a necessary prerequisite to understanding Soviet economic policies and to formulating US policy towards the USSR. Does the picture of the Soviet economy as drawn by the CIA square with the perception of the Soviet leaders? If substantial differences exist between the two, how and why do they differ and what are the implications for both the long-term and the short? Do the CIA and the Soviet leadership perceive the same problems, within the same contexts, the same order of priorities, the same trade-offs, and the same future? To what extent are the differences between the CIA and the Soviet leadership's assessments due to different criteria and reference points of measuring performance, and differing conceptions of the purpose, role and function of the Soviet economy in the Soviet system? To what extent is the Soviet leadership an inadvertent victim of its own mindset and to what degree may this misdirect the Soviet leadership in accurately defining problems and issues and the choice of policies in dealing with them? And finally, to what extent does the CIA's methodology reflect the academic and philosophical culture of the United States and thus inadvertently mirror-image the Soviet economy and its

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

problems and perceive it through an American prism rather than a Soviet?

2. Findings, Interpretation, Conclusions

CIA analysts recognize that the Soviet leadership's perceptions of the Soviet economy diverge from those of the CIA. In a study which documented the growth of Soviet military power and international influence ("The Soviet Challenge to U.S. Security Interests," 10 August 1982--National Intelligence Estimate), the deficiencies of the Soviet economy were listed in detail at the beginning of the study, after which the following observation was offered:

"It is likely that Soviet perceptions of their own predicament are less pessimistic than those of Western analysts, thus reducing the likelihood of major economic reforms."

Among the possible reasons for these differences in perceptions by the CIA and the Soviet leadership are the following:

a. The Soviet economy, unlike the American and other Western economies, is an explicit instrument of the political system. The relative optimism of Soviet leaders with respect to their economic problems, in contrast to the generally pessimistic tone of CIA and other Western analysts, derives from the Soviet leaders' perch at the apex of the Soviet system

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

and their control of the levers of society, including the economic system.

b. The Soviet leaders have access to data on the state and performance of the Soviet economy, which the CIA does not have. This may be an obvious observation, but the different perceptions of the Soviet leadership may reflect greater knowledge of the actual situation and thus result in greater confidence that the consequences, which the CIA forecasts, can be successfully avoided or ameliorated.

c. Many economic problems in all systems are hardly ever solved but simply managed at newer and later levels of development. The "solution" of one set of problems often generates another set; the issue really becomes not one of "solution," but of deciding what kinds of problems the Soviet leaders are prepared to live with and what kinds they find intolerable or unacceptable. These decisions are often determined by political or ideological considerations. Just as in the American economic scene, some sectors of the public would rather live with the problems of high unemployment rather than high inflation; whereas others might find the opposite more tolerable. In the Soviet situation, Soviet leaders must decide what set of problems to live with and manage, what set of problems to "solve," and what set of problems to avoid.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

For these reasons and others, the CIA has tended to underestimate the Soviet leadership's capacity for resourcefulness, improvisation, adaptation, accommodation, adjustment, manipulation and management of the total Soviet system, of which the economy is an integrated and subordinate component. This failure to accurately gauge Soviet leadership perceptions is in part responsible for the pessimistic tone of the CIA assessment over the past decade compared to the relatively optimistic view of the Soviet leadership. During the period when the CIA has forecast declining growth rates (which were accurate as such) and described the Soviet economy as in decline, the Soviet Union registered some of its most impressive achievements on the world scene, and emerged as an authentic global power that may have achieved military superiority (strategic, conventional and in some sectors, technological) over the United States.

During the decade under review, the Soviet GNP grew from 1.1 trillion dollars in 1970 to 1.6 trillion in 1981 and by the end of this decade, it may grow to almost 2 trillion dollars. The prospect of a 2 trillion dollar GNP by 1990 must be some source of comfort to the Soviet leadership as they develop policies to cope with their economic problems.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)3. Methodology, Sources of Data, and Data Base

Since little systematic work has been produced by the CIA dealing explicitly with and focused exclusively upon Soviet leadership perceptions of the Soviet economy and Soviet economic performance, no comprehensive methodology is apparent. Rather, the work is methodologically eclectic, but this is neither unusual nor necessarily an inadequacy. Dealing with perceptions is a difficult matter under the best of conditions and dealing with Soviet leadership perceptions is particularly difficult. The data base for examining perceptions is usually furtive, of uneven and frequently unknown reliability, and scanty. No methodological consistency or uniformity of interpretations is possible or even desirable, since the fragmentary and unreliable character of the data base invites considerable informed speculation and interpretation to fill in the lacunae.

This is particularly true of the CIA work on leadership issues, succession, leadership behavior and outlook. These studies, whether individual reports, or segments of the Monthly Review are of high quality. It must be emphasized, however, that such studies are speculative; they are typically not as reliable as reports based on hard intelligence. Nevertheless, policymakers require evaluative and informed speculative studies of this character, so that they can appreciate the

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

range of informed interpretation of this type of data, and understand the limits of reliability and validity involved. Such an understanding can give them an additional reference point against which to measure and evaluate their own judgments of the same data.

Much of the CIA's leadership and perception studies utilizes the various standard techniques of what is known as Kremlinology and Sovietology, and the CIA specialists are skilled and careful practitioners of this art. Both structured and unstructured content analysis are used in developing and analyzing the information; in some studies quantitative information is utilized extensively and in a very imaginative way. Other studies of equal quality rely less upon quantitative manipulation of data. These studies deal with a wide range of leadership perceptions of domestic and foreign policy issues, including perceptions of the economy, but are not specifically focused on economic perceptions.

Many of the studies under review, although of high quality, appear to use the various types of data available, whether hard, soft, of uncertain reliability or uncertain provenance, whether it be rumor, gossip or opinion, somewhat indiscriminately. As a result, the studies have the appearance of being more anecdotal and impressionistic, than analytical.

CONFIDENTIAL

Subtopic Evaluations and Recommendations (cont.)

Since methodologies are often more important for the assumptions structured and buried within them than how they process the data, CIA studies should distinguish between what is assumed (structurally or otherwise) and what is known. Although it is well known to specialists, policymakers are not always aware that built-in assumptions may prevail in the discipline or subdiscipline at any particular time and if they are changed, the analysis will change accordingly.

In its study of the Soviet economy, the CIA has paid little systematic attention to what Soviet leaders consider immutable or near immutable in the structure of the Soviet economy and society as distinguished from those aspects of the Soviet economy that can be altered, re-arranged or re-structured. More systematic attention should be directed to the scope of tolerable changes in the Soviet economy, how and why this is defined, and under what conditions the Soviet leadership might allow the current constraints to be burst in order to find solutions outside existing Soviet parameters.

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